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SMALL BUSINESS RETIREMENT AND BENEFIT EXTENSION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 1426

OCTOBER 23, 1987

Printed for the use of the Committee on Finance

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SMALL BUSINESS RETIREMENT AND BENEFIT EXTENSION ACT

FRIDAY, OCTOBER 23, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND
OVERSIGHT OF THE INTERNAL REVENUE SERVICE,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:03 a.m. in Room SD-215, Dirksen Senate Office Building, Hon. David Pryor (chairman) presiding.

Present: Senators Pryor and Heinz.

[The press release announcing the hearing, the prepared statements of Senators Pryor and Heinz and a description of S. 1426 follow:]

[Press Release # H-65—October 12, 1987]

FINANCE SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE TO HOLD A HEARING ON SMALL BUSINESS RETIREMENT AND BENEFIT EXTENSION ACT

Washington, D.C.—Senator David Pryor, (D., Arkansas), Chairman of the Senate Finance Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service, announced Wednesday that the Subcommittee will hold a hearing on his Small Business Retirement and Benefit Extension Act.

The hearing is scheduled for Friday, October 23, 1987 at 10:00 a.m. in Room SD-215 of the Dirksen Senate Office Building.

"We have found some disturbing trends," said Pryor. "Namely, even though small businesses are providing jobs for a growing segment of the labor force, they are less likely to provide pension benefits to their employees. If these trends continue, Congress will be faced with the problem of a large population of retirees not covered by private pensions. The strain this will place on the Social Security system could be disastrous."

Pryor said that the purpose of the bill is to provide tax incentives and encouragements to small businesses who want to set up pension plans. "We hope it will remove some of the obstacles which currently discourage the establishment of pension plans by small businesses and consequently allow small businesses to become more competitive with large companies who can better afford the costs of administering pension plans."

STATEMENT OF SENATOR DAVID PRYOR
CHAIRMAN OF THE FINANCE SUBCOMMITTEE ON PRIVATE
RETIREMENT PLANS AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE

DURING THE HEARING TODAY, WE WILL DISCUSS THE VARIOUS PROVISIONS IN THE SMALL BUSINESS RETIREMENT AND BENEFIT EXTENSION ACT AND HOW THEY MIGHT AFFECT COVERAGE FOR SMALL BUSINESS AND NON-PROFIT EMPLOYEES. BEFORE WE BEGIN, THOUGH, I WOULD LIKE TO TAKE JUST A MINUTE TO REVIEW THE EVOLUTION OF THE PRIVATE RETIREMENT SYSTEM DURING THIS CENTURY AND THE ROLE CONGRESS PLAYED IN SHAPING IT. IN THIS WAY, WE MAY DEVELOP A BETTER UNDERSTANDING OF WHERE THE SYSTEM IS TODAY, WHERE IT SHOULD BE AS WE ENTER THE TWENTY-FIRST CENTURY, AND WHAT COURSE CONGRESS SHOULD TAKE IN ITS DEVELOPMENT.

SOON AFTER CONGRESS CREATED PERSONAL AND CORPORATE INCOME TAX AT THE BEGINNING OF THIS CENTURY, THE INTERNAL REVENUE SERVICE RULED THAT EMPLOYERS MAY TAKE DEDUCTIONS FOR CONTRIBUTIONS TO RETIREMENT TRUSTS. IN THE REVENUE ACT OF 1921, CONGRESS CODIFIED THIS RULING AND PROVIDED THAT INTEREST INCOME OF PENSION TRUSTS WOULD BE MADE EXEMPT FROM TAXATION AND THAT CONTRIBUTIONS TO THE TRUST WOULD NOT BE TAXED UNTIL BENEFITS WERE DISTRIBUTED. THESE BASIC TAX ADVANTAGES REMAIN WITHIN THE INTERNAL REVENUE CODE TODAY AND ARE ESSENTIAL TO ENCOURAGING PENSION COVERAGE.

CONCERNED ABOUT THE POTENTIAL MISUSE OF RETIREMENT PLANS AS TAX SHELTERS FOR THE WEALTHY, CONGRESS ESTABLISHED NONDISCRIMINATION RULES IN THE REVENUE ACT OF 1942. WITH THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, CONGRESS IMPOSED FURTHER CONTRIBUTION AND BENEFIT LIMITS AND ESTABLISHED ADDITIONAL REQUIREMENTS FOR ELIGIBILITY, VESTING, EMPLOYER DEDUCTIONS AND BENEFIT ACCRUALS. IN THE RETIREMENT EQUITY ACT OF

1979, CONGRESS ENACTED LEGISLATION TO PROVIDE PROTECTION FOR SPOUSES OF PLAN PARTICIPANTS. IN 1982, CONGRESS IMPOSED AN ADDITIONAL LAYER OF RULES FOR SMALL BUSINESSES ON TOP OF THE GENERAL QUALIFICATION RULES. FINALLY, IN THE TAX REFORM ACT, WE LOWERED THE VESTING SCHEDULES, CONTRIBUTION LIMITS, AND THE AMOUNT OF SOCIAL SECURITY CONTRIBUTIONS THAT COULD BE CONSIDERED AS EMPLOYER CONTRIBUTIONS TO A PENSION.

THREE POINTS BECOME APPARENT FROM THIS ABBREVIATED LOOK AT PENSION HISTORY: FIRST, FOR BETTER OR FOR WORSE, CONGRESS HAS ACCELERATED MAJOR CHANGES TO THE PENSION LAWS OVER THE LAST DECADE; SECOND, THE RULES GOVERNING PENSION PLANS HAVE BECOME INCREASINGLY COMPLEX; AND, THIRD, THESE NEW RULES HAVE FOCUSED ON TAX EXPENDITURE EFFICIENCY RATHER THAN PROVIDING FURTHER TAX INCENTIVES FOR EMPLOYERS PROVIDING ADDITIONAL PENSION BENEFITS TO RANK-AND-FILE EMPLOYEES. BY THIS LAST POINT, I MEAN THAT WORKING WITHIN THE TRADITIONAL TAX INCENTIVES LAID DOWN IN THE FIRST PART OF THE CENTURY, CONGRESS HAS ATTEMPTED RECENTLY TO BRING MORE EMPLOYEES WITHIN THE SYSTEM BY INTRODUCING INCREASINGLY RESTRICTIVE QUALIFICATION RULES.

AFTER SIXTY YEARS OF CHANGE, WHERE DO WE STAND TODAY? AT FIRST GLANCE, THE PRIVATE RETIREMENT SYSTEM IS AN ASTONISHING SUCCESS. ACCORDING TO THE EMPLOYEE BENEFIT RESEARCH INSTITUTE, OVER THE LAST 20 YEARS, THE PROPORTION OF RETIREE HOUSEHOLDS RECEIVING PRIVATE PENSIONS AND THE SHARE OF THE ELDERLY'S INCOME ACCOUNTED FOR BY PENSIONS HAS MORE THAN DOUBLED. ADDITIONALLY, THE NUMBER OF PRIVATE PENSION PLANS HAS GROWN FROM AS FEW AS 400 PLANS IN 1925 TO OVER 795,000 IN 1984.

ALONG SIDE OF THESE IMPRESSIVE GAINS, HOWEVER, THERE ARE SOME DISTURBING SIGNS FOR THE FUTURE. NAMELY, PENSION COVERAGE FOR EMPLOYEES OF SMALL FIRMS HAS NOT KEPT PACE WITH THE GROWTH IN LARGER FIRMS, AT THE SAME TIME THAT SMALL BUSINESSES ARE

PROVIDING AN INCREASING PROPORTION OF THE NEW JOBS IN THE ECONOMY. FOR INSTANCE, APPROXIMATELY 19 PERCENT OF WORKERS IN FIRMS WITH UNDER 25 EMPLOYEES WORK FOR EMPLOYERS THAT OFFER PENSION COVERAGE, AS COMPARED TO 86 PERCENT IN FIRMS WITH OVER 500 WORKERS. IN FACT, IF FIRMS WITH FEWER THAN 100 EMPLOYEES OFFERED PENSION COVERAGE AS OFTEN AS FIRMS WITH 100 TO 500 EMPLOYEES, NEARLY 7 MILLION MORE WORKERS WOULD BE COVERED BY A PENSION.

SINCE THE BEGINNING OF THIS YEAR, I HAVE ASKED A NUMBER OF SMALL BUSINESS ORGANIZATIONS TO SURVEY THEIR MEMBERS TO DISCOVER WHY SMALL EMPLOYERS ARE NOT PROVIDING COVERAGE TO THEIR EMPLOYEES. THE TWO MOST REOCCURRING ANSWERS I RECEIVED WERE THAT THE ADMINISTRATIVE COMPLEXITY AND THE ADMINISTRATIVE COST OF MAINTAINING PENSION PLANS WAS TOO BURDENSOME. THESE BUSINESSES CITED THE EVER CHANGING LAWS, REDUNDANT RULES THAT DISCRIMINATE FOR NO APPARENT REASON AGAINST SMALL BUSINESSES, AND OVER-ABUNDANT PAPER WORK AS EXAMPLES. ADDITIONALLY, THEY POINT OUT THAT BECAUSE ADMINISTRATIVE COSTS ARE RELATIVELY FIXED, SMALL BUSINESSES END UP PAYING AS MUCH AS FOUR TIMES PER EMPLOYEE MORE THAN LARGE EMPLOYERS TO ADMINISTER THEIR PLANS.

THE PURPOSE OF THE SMALL BUSINESS RETIREMENT AND EXTENSION ACT IS TO ADDRESS MANY OF THESE CONCERNS, WHILE AT THE SAME TIME ENCOURAGING BOTH PROFIT AND TAX-EXEMPT EMPLOYERS TO PROVIDE THE GREATEST POSSIBLE COVERAGE TO RANK-AND-FILE EMPLOYEES. I LOOK FORWARD TO YOUR COMMENTS AND SUGGESTIONS FOR IMPROVING THE LEGISLATION.

STATEMENT BY SENATOR JOHN HEINZ (R-PA)
Subcommittee on Private Retirement Plans and IRS Oversight
October 23, 1987

MR. CHAIRMAN: I commend you for calling this hearing today to examine the "Small Business Retirement and Benefit Extension Act of 1987" and for your many efforts over the years to work with myself and others on the very important, and often very complex, issues involved in promoting private pensions.

I especially want to applaud you for the goal you have set with this legislation -- expanding pension benefit coverage among small firms. According to a report recently released by the House Ways and Means Committee, workers in small firms are nearly 2 and 1/2 times less likely as their counterparts in large companies to be covered by a pension plan. The administrative complexity of plans is only one of many reasons small entrepreneurs don't offer plans. Proportionately higher per-person administrative costs, low profit margins, large numbers of part-time workers, and the concentration of small businesses in the retail and service sector of the economy all contribute to lower coverage rates.

In working to fill the gaps in coverage rates among small firms, we must keep our eyes fixed on the ultimate goal of Federal pension law -- guaranteeing that employees have adequate income in retirement to allow them to live out their "golden" years in dignity and relative comfort.

I believe that our national retirement policy must meet two important goals. First, it must protect the interests of plan participants. Secondly, it must not overburden American business. It is not always easy to balance these two goals, but it must be done to ensure the adequacy and stability of our retirement system.

One of the most significant features of the "Small Business Retirement and Benefit Extension Act of 1987" is that it repeals the so-called "Top-Heavy Rules". These pension rules were implemented in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) to provide benefit protections for low-paid workers and to limit tax-favored benefits for business owners and highly-paid employees.

In 1985, when I introduced the Retirement Income Policy Act (RIPA), which was adopted as part of the Tax Reform Act of 1986, it was my goal to bring the entire pension system under a single set of uniform rules that would guarantee participants adequate retirement income by assuring early vesting, broad coverage, and significant benefit accrual. As I said at the introduction of the RIPA bill, I would support modifying or eliminating "Top-Heavy Rules" <u>if</u> we could sucessfully implement a uniform set of rules that would provide for adequate benefit protections for all workers, including those with low wages and mobile work histories.

Mr. Chairman, I look forward to the testimony today and hope that it will guide us as we seek to improve upon a system which benefits the great majority of American workers who depend on the private pension system to meet their needs in retirement.

DESCRIPTION OF S. 1426

(SMALL BUSINESS RETIREMENT AND BENEFIT EXTENSION ACT)

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of S. 1426, the Small Business Retirement and Benefit Extension Act (introduction by Senator Pryor). The bill is scheduled for a public hearing on October 23, 1987, before the Senate Finance Subcommitte on Retirement Plans and Oversight of the Internal Revenue Service.

The first part of the document is a summary of the bill. The second part is a description of the provisions of S. 1426 and present law, relating to (a) top heavy plans, (b) tax credit for administrative costs of maintaining a qualified plan, (c) modifications of certain provisions of the Tax Reform Act of 1986, (d) simplification of reporting requirements for small plans, and (e) treatment of certain meals as de minimis fringe benefits.

I. SUMMARY OF THE BILL

Top heavy plans

The bill would repeal the special rules for top heavy plans for any plan year beginning after December 31, 1987.

Tax credit for plan administrative costs

The bill would provide an income tax credit to eligible employers. The credit would be determined by reference to the administrative cost of maintaining a qualified pension, profit-sharing, or stock bonus plan that meets specified vesting requirements, or a simplified employee pension (SEP). The full amount of the credit would be provided for an eligible employer with not more than 50 employees. The credit would be reduced for eligible employers with more than 50 employees. The credit would apply for taxable years beginning after December 31, 1987.

Statutory employee benefit plans

The bill would defer the effective date of provisions of the Tax Reform Act of 1986 relating to nondiscriminatory benefits under statutory employee benefit plans. Under the bill, the nondiscrimination rules added by the 1986 Act would generally apply for plan years beginning after the later of

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of S. 1426 (Small Business Retirement and Benefit Extension Act) (JCX-18-87), October 22, 1987.

(1) December 31, 1990, or (2) the earlier of December 31, 1991, or the date 3 months after the issuance of Treasury regulations. The bill would repeal the applicability of the new nondiscrimination rules to church plans.

Uniform definition of compensation

The bill would defer for one year the effective date of the uniform definition of compensation provided by the Tax Reform Act of 1986.

Tax sheltered annuity programs

The bill would permit exclusions from gross income under a tax sheltered annuity program for any employee of an employer that is exempt from income tax under the Code. In addition, the bill would eliminate restrictions imposed by the Tax Reform Act of 1986 on distributions of amounts attributable to contributions made under salary reduction agreements. The bill would also provide an inflation adjustment for the generally applicable $9,500 annual limit on salary reduction deferrals.

The bill would defer the effective date of the nondiscrimination requirements added by the Tax Reform Act of 1986. Under the bill, the requirements would apply to years beginning after the later of (1) December 31, 1989, or (2) two years after the date on which final regulations implementing the provision of the 1986 Act are issued.

Excise tax on excess distributions

The bill would repeal the excise tax imposed by the Tax Reform Act of 1986 on excess distributions. The bill would also repeal the estate tax imposed by the Act on excess retirement accumulations.

Simplification of reporting requirements

The bill would permit small plans to meet the requirements of ERISA with respect to the distribution of summary annual reports by notifying participants that that a copy of the report is available upon request. The bill would also express the intent of Congress that pension forms for small plans be simplified.

Treatment of certain meals as de minimis fringe benefits

The bill would provide that 50 percent of any qualified employer meal reimbursement furnished to an employee is to be treated as a de minimis fringe benefit. The exclusion would apply if the employer does not operate an eating facility for employees on or near the business premises.

II. DESCRIPTION OF S. 1426 ("Small Business Retirement and Benefit Extension Act")

A. Top Heavy Plan Rules (Sec. 2 of the bill and sec. 416 of the Code)

Present Law

Overview

In general.--Under the Code, additional qualification requirements are provided for plans which primarily benefit an employer's key employees (top heavy plans). These additional requirements (1) provide greater portability of

benefits for plan participants who are non-key employees by requiring more rapid vesting, (2) provide minimum nonintegrated contributions or benefits for plan participants who are non-key employees, and (3) reduce the aggregate limit on contributions and benefits for certain key employees.

Top heavy test.--Under the Code, a defined benefit pension plan is a top heavy plan for a plan year if, as of the determination date, the present value of the cumulative accrued benefits for participants who are key employees for the plan year exceeds 60 percent of the present value of the cumulative accrued benefits for all employees under the plan. A defined contribution plan is a top heavy plan for a plan year if, as of the determination date, the sum of the account balances of participants who are key employees for the plan year exceeds 60 percent of the sum of the account balances of all employees under the plan. In addition, a plan is top heavy if it is required to be a part of an aggregation group and that group is top heavy. Under the rules for top heavy plans, a simplified employee pension (SEP) is considered to be a defined contribution plan. The determination date for any plan year is generally the last day of the preceding plan year.

Key employee.--Generally, a key employee is an employee who, at any time during the plan year or any of the 4 preceding plan years is (1) an officer of the employer with annual compensation in excess of an inflation-adjusted amount ($45,000 for 1987), (2) one of the 10 employees having annual compensation from the employer of more than an inflation-adjusted amount ($30,000 for 1987) and owning (or considered as owning) the largest interests in the employer, (3) a 5-percent owner of the employer, or (4) a 1-percent owner of the employer having an annual compensation from the employer of more than $150,000. No more than 50 employees of an employer are considered to be key employees solely because of officer status. Further, if 2 employees have the same interest in the employer, then the employee having the greater annual compensation from the employer is treated as having a larger interest.

Vesting under top heavy plans

For any plan year for which a plan is top heavy, an employee's right to the accrued benefit derived from employer contributions must become nonforfeitable under a vesting schedule that meets the requirements of one of two alternative vesting schedules. The vesting schedule for a top heavy plan applies to all accrued benefits under the plan (including benefits accrued before the top heavy plan rules apply) whether or not the accrued benefits are required by the top heavy plan rules and whether or not they accrued while the plan was top heavy.

A plan meets the first alternative vesting schedule (3-year, full vesting) if a participant who has completed at least 3 years of service with the employer or employers maintaining the plan has a nonforfeitable right to 100 percent of the accrued benefit derived from employer contributions. A plan meets the requirements of the second alternative vesting schedule (6-year, graded vesting) if a participant has a nonforfeitable right to at least 20 percent of the accrued benefit derived from employer contributions at the end of 2 years of service, 40 percent at the end of 3 years of service, 60 percent at the end of 4 years of service, 80 percent at the end of 5 years of service, and 100 percent at the end of 6 years of service with the employer.

Minimum benefits under top heavy plans

In general.--A qualified plan that is top heavy is required to provide a minimum benefit or contribution derived from employer contributions. The minimum benefit or contribution is to be provided for each employee who is a participant in the plan and who was not a key employee with respect to the determination date. Special rules permit plans to avoid duplicating benefits or contributions for employees who are covered under more than one plan of the employer.

Defined benefit plans.--A defined benefit pension plan meets the minimum benefit requirement if, on a cumulative basis, the accrued benefit of each participant who is not a key employee, when expressed as an annual retirement benefit, is not less than 2 percent of the employee's average annual compensation from the employer during the employee's testing period, multiplied by the employee's years of service with the employer. An employee's minimum benefit is not, however, required to exceed 20 percent of the employee's average annual compensation. The minimum benefit may not be reduced under rules permitting integration of plans with benefits under the Social Security Act.

Defined contribution plan.--Under a defined contribution plan, the minimum contribution for a participant is generally 3 percent of the participant's compensation for the year. The minimum contribution is reduced if no employer contributions for key employees do not exceed 3 percent. The minimum contribution may not be reduced under rules permitting integration of plans with benefits under the Social Security Act.

Limitations on benefits and contributions for key employees

In general.--The Code provides additional rules with respect to the overall limits on contributions and benefits for a key employee who participates in a defined benefit pension plan and a defined contribution plan of the same employer. Under the additional rules, unless certain requirements are met, for any year for which the plans are included in a top heavy group of plans, the overall limits are reduced.

Additional minimum benefit or contribution.--The reduced limits do not apply under a plan that is included in a top heavy group if the plans in which the key employee participates (1) meet the requirements of a concentration test, and (2) provide either an extra minimum benefit or an extra minimum contributions. The extra benefit or contribution in non-integrated and is in addition to the minimum benefit or contribution required for all top heavy plans. The concentration test is met for a year if the plan is not more than 90 percent top heavy (the plan is not super top heavy).

Extra minimum benefit.--The extra minimum benefit is the lesser of (1) 1 percent of the employee's average annual compensation, multiplied by the employee's years of service with the employer, or (2) 10 percent of the employee's average annual compensation.

Extra minimum contribution.--The extra minimum contribution is 1 percent of the employee's compensation for the year.

Explanation of Provision

The bill would repeal the special rules for top heavy plans for any plan year beginning after December 31, 1987.

B. Credit for Administrative Costs of Maintaining a Qualified Plan (Sec. 3 of the bill and sec. 38(b) and new sec. 43 of the Code)

Present Law

Under present law, the administrative cost of maintaining a qualified plan is generally allowed as a business expense deduction. Present law does not provide a tax credit for these costs.

Explanation of Provision

In general.--The bill would provide an income tax credit to eligible employers. The credit would be determined by reference to the administrative cost of maintaining a qualified pension plan (a qualified pension, profit-sharing, or stock bonus plan that meets specified vesting requirements, or a simplified employee pension (SEP)). The full amount of the credit would be provided for an eligible employer with not more than 50 employees. The credit would be reduced for eligible employers with more than 50 employees. The credit would apply for taxable years beginning after December 31, 1987.

Eligible employer.--The bill would define an eligible employer as an employer which, during the taxable year, has an average number of employees per applicable period that is not greater than 100. The employer aggregation rules applicable under the rules for qualified plans would apply in determining the eligible status of an employer. Under the bill, the applicable period is the employer's payroll period or such other period (not greater than 3 months) as the employer may elect.

Amount of credit.--For a taxable year, the credit would generally be 14 percent of an amount determined on the basis of the deduction allowed for the year for employer contributions under plans of deferred compensation. The amount on which the credit would be based would be limited to the portion of the deductible amount determined with respect to employees who are not highly compensated employees. Carryforwards to the year would be disregarded. For a defined contribution plan, the credit for a taxable year could not exceed $2,000. For a defined benefit pension plan, the credit for a taxable year would be limited to $4,500. The bill provides special rules for the determination of the portion of the deductible amount for a taxable year that is allocable to employees who are not highly compensated.

Phase-out of credit.--Under the bill, the amount of the credit determined under the general rules would be reduced for eligible employers with more than 50 employees. The amount of the reduction would be the amount that bears the same ratio to the credit otherwise determined as (1) the average number of employees of the employer per applicable period in excess of 50, bears to (2) 50. Accordingly, no credit would be allowed for an employer with 100 or more employees during an applicable period.

Vesting requirements.--Under the bill, the credit would be provided with respect to a qualified pension plan under which the nonforfeitable percentage of accrued benefits derived from employer contributions meets the requirements of a prescribed vesting schedule. Under the schedule, the nonforfeitable percentage would be 25 percent for an employee who has completed 1 year of service. The nonforfeitable percentage would increase by 25 percentage points for each additional year of service so that, after completion of 4

years of service, all of a participant's accrued benefit derived from employer contributions would be nonforfeitable.

C. Modification of Provisions of the Tax Reform Act of 1986

1. Statutory employee benefit plans (sec. 4(a) of the bill and sec. 1151(k)(1) of the Tax Reform Act)

Present Law

In general.--The Code, as amended by the Tax Reform Act of 1986, provides nondiscrimination rules for statutory employee benefit plans (including accident or health plans, group-term life insurance plans). At the election of the employer, the rules also apply to qualified group legal services plans, educational assistance plans, and dependent care assistance programs. The provisions generally apply to plan years beginning after the later of (1) December 31, 1987, or (2) the earlier of December 31, 1988, or the date 3 months after the issuance of Treasury regulations. The provisions apply to a statutory employee benefit plan of a church a for years beginning after December 31, 1988.

Prior law provided separate nondiscrimination tests for health benefit plans, group-term life insurance plans, group legal services plans, educational assistance programs, and dependent care assistance programs. Nondiscrimination rules apply with respect to a fund that forms a part of a welfare benefit plan.

Applicable tests.--Under the nondiscrimination rules of present law, a plan generally is required to meet 3 eligibility tests and a benefits test. The eligibility tests are referred to as the 50-percent test, the 90-percent/50-percent test, and the nondiscriminatory provision test. Alternatively, a plan may meet the requirements by satisfying an 80-percent coverage test and the nondiscriminatory provision test. If specified requirements are met, the nondiscrimination rules may be applied on the basis of lines of business or operating units.

The Secretary of the Treasury is to prescribe rules regarding valuation of benefits. With respect to health coverage, the Secretary is to prescribe a table providing the relative values of various types of health coverage.

Generally, each separate option provided under an employee benefit program is a separate plan for testing purposes. Under the Code, however, aggregation rules allow plans to be tested together based on their relative values.

Consequences of discrimination.--If a plan is discriminatory, then under present law, the value of the discriminatory excess is includible in the gross income of highly compensated employees. If the employer does not report the excess in a timely manner, then the employer may be subject to an employer-level sanction.

Additional requirements.--The 1986 Act amended the Code to provide a benefits test applicable to dependent care assistance programs. In addition, the 1986 Act provided new reporting requirements for employee benefit plans.

Explanation of Provision

The bill would defer the effective date of the provisions of the 1986 Act. Under the bill, the rules would

apply to plan years beginning after the later of (1) December 31, 1990, or (2) the earlier of December 31, 1991, or the date 3 months after the issuance of Treasury regulations. The bill would repeal the applicability of the provisions to church plans.

2. Definition of compensation (sec. 4(b) of the bill and sec. 1115(b) of the Tax Reform Act)

Present Law

The Code, as amended by the Tax Reform Act of 1986, provides a definition of the term "compensation". The definition applies uniformly for purposes of employee benefit rules unless another definition is expressly provided. The uniform definition is generally the same as the definition applicable for purposes of the overall limits on contributions and benefits. The uniform definition of compensation applies to years beginning after December 31, 1986.

Under the Code, however, an employer may elect to treat certain salary reduction amounts under a qualified cash or deferred arrangement (a 401(k) plan), a tax sheltered annuity program, a simplified employee pension, or a cafeteria plan as compensation. The election may be made if the treatment of these salary reduction amounts is applied on a consistent basis under rules prescribed by the Secretary of the Treasury.

The Secretary of the Treasury is required to prescribe alternative definitions of compensation for use by employers in applying the coverage and nondiscrimination rules for qualified plans. The alternative definitions are to include the basic or regular compensation of employees (that is, bonuses and overtime pay are to be disregarded). An employer may use an alternative definition only if that use does not result in discrimination in favor of highly compensated employees, determined in an objective fashion on the basis of the employees' compensation as defined for purposes of the overall limits on contributions.

Explanation of Provision

The bill would defer the effective date of the uniform definition of compensation added by the 1986 Act. Under the bill, the definition would apply to years beginning after December 31, 1988.

3. Tax sheltered annuity programs (sec. 4(c) of the bill, secs. 403(b) and 402 of the Code, and secs. 1120(c) and 1123 of the Tax Reform Act of 1986)

Present Law

In general.--Under present law, an amount contributed by an employer for a taxable year to purchase an annuity contract for an employee is excluded from the employee's gross income (within limits) for that year if the employer, the employee, the contract, and the contributions meet specified requirements. A nondiscrimination standard applies to the plan under which the contribution is made. Amounts held under an employee's tax sheltered annuity contract are generally not includible in the gross income of the employee until those amounts are paid. The Code applies a minimum distribution requirement to tax sheltered annuity contracts.

Employee requirements.--The exclusion is allowed for any employee of a tax-exempt organization that meets the employer requirements. The exclusion applies to an employee of a state, etc., only if the employee performs services for an educational organization.

Contract requirements.--Contributions to purchase a contract meet the requirements for the exclusion only if the contract meets standards relating to nonforfeitability of employee rights and to nondiscrimination. An amount paid by an employer to a custodial account may be treated as an amount contributed by the employer for an annuity contract. The exclusion does not apply to amounts under a qualified annuity plan.

Nondiscrimination requirements.--If a contract is not purchased by a church, then for years beginning after 1988, nondiscrimination standards apply to the plan under which the contract is purchased. Generally, for salary reduction amounts, the nondiscrimination standard requires that all employees be eligible to elect salary reduction. For other amounts, the nondiscrimination standard is generally the same as the nondiscrimination standard applicable to qualified pension plans. The nondiscrimination requirements were added by the Tax Reform Act of 1986.

Contribution requirements.--A contribution meets the requirements for exclusion if it meets requirements relating to the timing and amount of the contribution. The timing requirements are met if the employee's rights under the contract are nonforfeitable when the contribution is made. An employee's excludable contributions are generally limited to (1) 20 percent of the employee's compensation (as reduced by the contribution), multiplied by (2) the number of the employee's years of service with the employer, and reduced by excludable contributions made in prior years.

Overall contribution limit.--Limitations apply with respect to annual additions under tax sheltered annuity programs. The limit on annual additions takes into account amounts contributed to all tax sheltered annuity programs, qualified plans, and simplified employee pensions maintained by the employer. A program does not meet the requirements of the Code if contributions exceed the overall limits.

Salary reduction agreements.--An annual exclusion limit applies with respect to amounts deferred under salary reduction agreements. The exclusion limit encompasses all tax sheltered annuity programs under which an employer contribution has been made, nonqualified plans of deferred compensation maintained by tax exempt or certain governmental employers, as well as cash or deferred arrangements and simplified employee pensions. Generally, the amount deferred under a tax sheltered annuity salary reduction agreement for a taxable year is limited to $9,500. The $9,500 limit is not adjusted for inflation. Special catch-up limits apply with respect to employees who are nearing retirement.

The Code provides restrictions on the time of distribution for benefits attributable to contributions made pursuant to a salary reduction agreement. Those benefits may not be paid earlier than (1) when the employee attains age 59 1/2, separates from service, dies or becomes disabled, or (2) in the case of hardship. No amount of income attributable to a contribution made under a salary reduction agreement may be distributed on account of hardship.

Employer requirements.--The exclusion does not apply unless the employer (1) is described in the provision of the Code defining organizations that may qualify as tax exempt charities (sec. 501(c)(3)), or (2) the employer is a State, a political subdivision of a State, or an agency or instrumentality thereof.

Explanation of Provision

Extension to other tax-exempt organizations.--The bill would permit exclusions from gross income under a tax sheltered annuity program for any employee of an employer that is exempt from income tax under the Internal Code of 1986.

Salary reduction agreements.--The bill would eliminate the special restrictions on distributions of amounts attributable to contributions made under salary reduction agreements. This provision would take effect as if included in the 1986 Act. In addition, the bill would provide an inflation adjustment for the generally applicable $9,500 annual limit on deferrals under a salary reduction agreement.

Nondiscrimination requirements.--The bill would defer the effective date of the nondiscrimination requirements added by the Tax Reform Act of 1986. Under the bill, the requirements would apply to years beginning after the later of (1) December 31, 1989, or (2) two years after the date on which final regulations implementing the provision of the 1986 Act are issued.

4. Treatment of excess distributions (sec. 4(d) of the bill and sec. 1133 of the Tax Reform Act)

Present Law

Excise tax on excess distributions

The Code imposes an excise tax on excess distributions from qualified retirement plans, tax sheltered annuity programs, and individual retirement accounts (IRAs). The tax is equal to 15 percent of excess aggregate annual distributions paid to a participant from one of these arrangements. The excise tax on excess distributions is reduced by the amount of the 10-percent tax on early withdrawals. An additional estate tax applies to excess retirement accumulations. The excise tax on excess distributions applies to distributions made after December 31, 1986.

Under the Code, excess distributions are defined as the aggregate amount of retirement distributions made with respect to any individual during any calendar year, to the extent the aggregate amount exceeds an annual ceiling. The annual ceiling for a year is the greater of (1) $150,000, or (2) $112,500 (as adjusted for inflation).

Special provisions apply with respect to lump sum distributions. Under the special provisions, the threshold amount for determining the excess portion of a distribution is 5 times the otherwise applicable limit (e.g. $750,000 if the $150,000 limit would otherwise apply).

Estate tax treatment

The Code provides special rules for amounts not distributed before the death of a participant. Under the rules for post-death distributions, an additional estate tax is imposed on the estate of the deceased participant. The

additional estate tax is measured by the excess retirement accumulation at the time of the participant's death. Under the Code, the excess retirement accumulation is the excess (if any) of the value of the decedent's interests in all qualified retirement plans, annuity plans, tax sheltered annuity programs, and IRAs, over the present value of annual payments equal to the annual ceiling (e.g. $150,000) over a period equal to the life expectancy of the individual immediately before death. Under the Code, amounts accumulated as of August 1, 1986 are not subject to the tax on excess distributions. The additional estate tax applies to the estates of decedents dying after December 31, 1986.

Explanation of Provision

The bill would repeal the excise tax on excess distributions and the estate tax on excess retirement accumulations. Under the bill, the law would be applied and administered as if these taxes had not been enacted.

D. Simplification of Reporting Requirement for Small Plans (Sec. 5 of the bill and sec. 104(b)(3) of ERISA)

Present Law

Under present law, an employee pension benefit plan is required to provide a summary annual report to participants and beneficiaries. Alternate payees are also entitled to receive the reports. Present law authorizes the Secretary of Labor to prescribe simplified annual reports for any pension plan that covers fewer than 100 participants.

Explanation of Provision

The bill would provide that in the case of a plan with fewer than 100 participants at any time during a plan year, the administrator may fulfill the requirements with respect to providing the summary annual report to employees by providing participants with a copy of the annual report for the year or by notifying them in writing that a copy of the report is available upon request.

The bill would provide that it is the intent of Congress that, in the case of a qualified retirement plan with fewer than 100 participants during a plan year, the government forms required to be completed for the year should be designed so that a person with no expertise in the area of employee benefits could complete the required forms. The bill states that it is the sense of Congress that the forms currently in use do not meet this standard. The bill would provide that no later than 1 year after the date of the its enactment the Secretaries of the Treasury and of Labor or their delegates are to redesign the forms used in administering those plans, particularly Form 5300 and the Form 5500 series, to satisfy the intent of Congress. The bill would require that the Secretaries report to Congress on the actions they have taken to comply with this requirement.

E. Treatment of Certain Meals as De Minimis Fringe Benefits (Sec. 6 of the bill and sec. 132(e) of the Code)

Present Law

Meals furnished on employer premises.--The Code provides that the value of meals furnished by an employer to an employee, the employee's spouse, or any of the employee's dependents is excluded from the employee's gross income if specified requirements are met. The Code requires that the

meals be furnished for the convenience of the employer and that the meals be furnished on the business premises of the employer.

Meals furnished at employer facility.--The Code also provides that a fringe benefit provided by an employer to an employee may be excluded from the employee's gross income if certain requirements are met. Meals furnished by an employer may be excluded from gross income as a de minimis fringe benefit if (1) the meals are furnished at an eating facility operated by the employer for employees, (2) the facility is located on or near the business premises of the employer, and (3) revenue derived from the facility normally equals or exceeds the direct operating costs of the facility.

Highly compensated employees.--The treatment of meals as a de minimis fringe benefit is available to a highly compensated employee only if access to the facility is available on substantially the same terms to each member of a group of employees that is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees.

Explanation of Provision

In general.--The bill would supplement the rules of present law by providing that 50 percent of any qualified employer meal reimbursement furnished to an employee is to be treated as a de minimis fringe benefit. The exclusion would apply if the employer does not operate an eating facility for employees on or near the business premises. The provision would apply to benefits received after the date of enactment, in taxable years ending after that date.

Highly compensated employees.--In the case of a highly compensated employee, the treatment of a qualified employer meal reimbursement as a de minimis fringe benefit would apply only if the employer shares in the cost of off-premises meals provided to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees.

Qualified employer meal reimbursement.--The bill defines a qualified employer meal reimbursement as any amount that an employer furnishes in kind for any meal furnished to an employee off the business premises. Under the bill, an amount is not a qualified employer meal reimbursement unless (1) the employer does not provide more than 1/3 of the cost of the meal, (2) the employer does not share in the costs of more than 1 meal per working day, and (3) the meal is furnished during normal business hours.

Effective date.--The provision would apply to benefits received after the date of enactment of this Act in taxable years ending after such date.

Senator PRYOR. Good morning, ladies and gentlemen.

During the hearing this morning—and I emphasize "this morning"; we will conclude by 12:00 at the latest—we are going to discuss the various provisions in The Small Business Retirement and Benefit Extension Act in how they might affect coverage for small business and nonprofit employees.

Before we begin, though, I would like to take just a moment to review the evolution of the private retirement system during this century and the role the Congress played in shaping it. This way, we might develop a better understanding of where that system is today, where it should be as we enter the 21st century, and what course the Congress should take in its development.

Soon after Congress created the personal and corporate income tax at the beginning of this century, the Internal Revenue Service ruled that employers may take deductions for contributions to retirement funds. In the Revenue Act of 1921, Congress codified this ruling and provided that interest income of pension benefits, of pension trusts, would be made exempt from taxation, and the contributions to the trust would not be taxed until benefits were distributed.

These basic tax advantages remain within the Internal Revenue Code today, and they are essential to encouraging pension coverage.

Concerned about the potential misuse of retirement plans as tax shelters for the wealthy, Congress established nondiscrimination rules in the Revenue Act of 1942. With the Employee Retirement Income Security Act of 1974, Congress imposed other contribution and benefit limits and established additional requirements for eligibility, vesting, employer deductions and benefit accruals. In the Retirement Equity Act of 1979, Congress enacted legislation to provide protection for spouses of plan participants. In 1982 the Congress imposed an additional layer of rules for small businesses, on top of the general qualification rules.

Finally, in the Tax Reform Act we lowered the vesting schedule, the contribution limits, and the amount of Social Security contributions that could be considered as employer contributions to a pension.

Three points become very apparent from this abbreviated look at pension history:

One, for better or for worse, Congress has accelerated major changes to the pension laws over the last decade.

Two, the rules governing pension plans have become increasingly complex; and

Three, these new rules have focused on tax-expenditure efficiency rather than providing further tax incentives for employers to provide an additional pension benefit to rank and file employees.

By this last point, I mean that working within the traditional tax incentives laid down in the first part of the century, Congress has now attempted recently to bring more employees within the system by introducing increasingly restrictive qualification rules.

After 60 years of change, where do we stand today? At first glance the private retirement program or system is an astonishing success. According to the Employee Benefit Research Institute, over the last 20 years the proportion of retiree households receiv-

ing private pensions, and the share of the elderly's income accounted for by pensions, has more than doubled.

Additionally, the number of private pension funds or plans has grown from as few as 400 back in 1925 to over 795,000 in 1984.

Along side of these impressive gains, however, there are some disturbing signs for the future. Namely:

Pension coverage for employees of small funds have not kept pace with the growth in larger funds, at the same time that small business are providing an increasing proportion of the new jobs in the economy.

For instance: approximately 19 percent of workers in firms with under 25 employees work for employers that offer pension coverage, as compared to 86 percent in firms with over 500 workers. In fact, the firms with fewer than 100 employees offered pension coverage as often as firms with 100 to 500 employees, nearly 7 million more American workers would be covered by a pension.

Since the beginning of this year I have asked a number of small business organizations to survey their members, to discover why small employers are not providing coverage to their employees. The two most recurring answers that I received were that the administrative complexity and the administrative cost of maintaining pension plans is too burdensome.

These businesses cited the ever-changing laws, redundant rules that discriminate for no apparent reason against small businesses, and over-abundant paperwork as examples.

Additionally, these individuals pointed out that because administrative costs are relatively fixed, small businesses are ending up paying as much as four times, per employee, more than large employers to administer the respective plans.

The purpose of the Small Business and Retirement Extension Act is to address many of these concerns, while at the same time encouraging both profit and tax-exempt employers to provide the greatest possible coverage in rank and file employees.

I look forward to your comments this morning. I look forward to those suggestions. I look forward to your statements on ways that we might improve this legislation, to address some of the challenges that we face in improving pension coverage.

One, let me say that we have a large number of witnesses this morning; therefore, each witness is going to abide by a 5-minute rule.

Through the courtesy of our little light switch here, you will see that the green light will go on when you start your testimony, and about 1 minute before your testimony is up, I believe, the yellow light will go, and then we will see the red light when your time is finished. At that time I will use the gavel and we will put the balance of your statement in the record.

The purpose here is to build a record. It is to receive the testimony of those individuals affected and who are spokespersons for not only employee groups but also for various business interests in the United States. So, we will begin building that record, and we will call our first panel this morning.

That first panel consists of Mr. Frank Swain, Chief Counsel for Advocacy, U.S. Small Business Administration; Paula Calimafde, President-elect, Small Business Council of America; and Dr. Emily

S. Andrews, Research Director, Employee Benefit Research Institute. We look forward to your statements this morning. We appreciate our being here.

I will call on Mr. Swain first.

STATEMENT OF HON. FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC

Mr. SWAIN. Mr. Chairman, thank you very much. As indicated, I will summarize my statement if the entire statement will be received in the record.

Mr. Chairman, the purpose of your bill is to encourage small businesses to provide retirement benefits by repealing the top-heavy rules, allowing a tax credit to businesses maintaining plans with fewer than 100 employees, and mandating reduction and simplification of pension paperwork requirements, and, additionally, delaying the effective date of the nondiscrimination rules imposed by the Tax Reform Act of 1986.

Now, as your opening statement indicated, the reason why we feel this legislation is important is because of the simple policy reason that not very many employees of small firms are covered by pension plans. And there are a number of reasons, as your statement indicated, that not very many small firm employees are covered by pension plans:

The first and foremost is profitability, and I think it is important to mention that because sometimes people in Congress—and certainly I think you are a clear and notable exception—believe that the easy answer is to mandate that something be done. Well, we can't mandate that all firms have pension plans, because most of them don't simply have the profitability to sustain it.

As your opening statement indicated, the second and equally important reason is that there is a disproportionately high cost and complexity of plan administration for smaller firms. Additional reasons include the limits on benefits the business owners can obtain from plans and the constantly changing legal and regulatory environment for pension plans that makes costs very high. Since 1982 there have been four significant laws passed by the Congress that have required major revisions in pension plans—TEFRA, in 1982, the Deficit Reduction Act, the Retirement Equity Act, and most recently the Tax Reform Act of 1986.

The apparent but unintended effect of these laws has been to impede new plan formation and to encourage the termination of existing retirement plans. In short, the costs of maintaining and establishing a pension plan for small firms are becoming too high and the benefits too low for many employers to be interested in sponsoring pension plans.

Because of these recent changes in the law, I am concerned that the gap between large and small firms in the provision of pensions is likely to grow rather than to be improved.

A growth of the sector of employees not covered by pension plans ultimately could lead lawmakers to view a mandated pension system as a solution, as the current debate on mandated health insurance certainly demonstrates. Ironically, the failure of Govern-

ment regulation and policy to expand the voluntary pension system would be a significant factor in creating an environment in which mandated retirement benefits would be considered a solution. In other words, we are going to see a situation in which fewer and fewer employees are covered by pension plans, largely because of laws and regulations, and some people are going to wring their hands and say, "This is a terrible thing. We should pass a law that requires everyone to be covered by a plan." I think your approach is far better.

I would want to talk specifically about that provision of S. 1426 which involves repeal of the top-heavy rules. Now, the top-heavy rules, as you know, are certainly a complicated set of regulations that apply to virtually all retirement plans. In practice, the rules have proved to be complicated and costly to administer and a disincentive to small employers to sponsor retirement plans. The rules apply where retirement plans predominately benefit what are defined as "key employees."

I think the important thing to remember is that, regardless of the presumably laudable social or pension policy goals that stimulated the enactment of top-heavy rules in the first place, the fact is that where one is concerned with a small firm, in many if not most cases, there are a large number of key employees, since the regulations define "key employees" in almost all situations as "owners." So, if you have a large number of owners relative to this small number of employees, which is very frequently the case in small firms, obviously, then they are almost inevitably going to fall under the top-heavy rules.

The rules limit the benefits available to the key employees and require additional benefit protections for rank and file workers.

While we have long questioned the need for special top-heavy rules on top of all the normal pension requirements, the key factor is that the Tax Reform Act of 1986 extends a number of top-heavy concepts to all retirement plans.

So, I think the question is, No. 1, whether top-heavy rules are necessary or useful in the first place for small firms; and, secondly and more acutely, whether top-heavy rules are necessary at all in light of the provisions in the Tax Reform Act of 1986 which extend top-heavy-like concepts to all retirement plans. I think that in light of the 1986 TRA provisions especially, it is appropriate to repeal the top-heavy provisions in their entirety, so that we can go about the business of having small firms form pension plans based on their interest in helping their workers and not deterred from that based on the expense to employers from administrative costs.

We have several specific comments in our statement, and I will be happy to respond to your questions and those of the committee.

Thank you, Mr. Chairman, for your interest.

[Mr. Swain's prepared statement follows:]

TESTIMONY OF

HONORABLE FRANK S. SWAIN

CHIEF COUNSEL FOR ADVOCACY

U.S. SMALL BUSINESS ADMINISTRATION

- The Small Business Retirement and Benefit Extension Act, S. 1426, encourages small businesses to provide retirement benefits by repealing the top-heavy rules. The act allows a tax credit to businesses maintaining plans with fewer than 100 employees and mandating reduction and simplification of pension paperwork requirements.
- The need for special top-heavy rules for small plans has been eliminated by the Tax Reform Act of 1986 which extends a number of the top-heavy concepts to all plans.
- Repealing the top-heavy rules could be an important step in unifying, simplifying and promoting pensions for small employers.
- Small employers, half of whom administer their own retirement plans, rank reporting and disclosure requirements the most burdensome aspects of all pension regulation. S.1426 requires the simplification of filing requirements so that the forms are understandable by nonpension experts.

Mr. Chairman:

Thank you for the opportunity to present my views on the Small Business Retirement and Benefit Extension Act (S. 1426). The Office of Advocacy of the U.S. Small Business Administration (SBA) was created by Congress in 1976 to advocate the interests of small business before Congress and Federal agencies. My role today is to discuss the likely impact of S. 1426 on small employers. I emphasize that the views expressed herein are mine only; I do not speak for the Administration on tax, retirement and employee benefit issues.

Mr. Chairman, the small business community applauds your efforts to understand and remove some of the impediments to pension plan sponsorship by small firms. The Small Business Retirement and Benefit Extension Act is the first positive piece of legislation in years for small employers that currently, or someday hope to provide employee benefits. The

bill would encourage small businesses to provide retirement benefits by repealing the top-heavy rules, allowing a tax credit to businesses maintaining plans with fewer than 100 employees and mandating reduction and simplification of pension paperwork requirements. Additionally, the bill would assist businesses providing health care benefits by delaying the effective date of the nondiscrimination rules imposed by the Tax Reform Act of 1986.

Employee benefits are important to the small employer because they help small businesses to compete for the most qualified workers and consequently compete in the provision of goods and services. Small businesses employ approximately 55 percent of our Nation's workers and provide nearly half of private sector national product. Nearly 88 percent of businesses in the United States employ fewer than 20 employees.

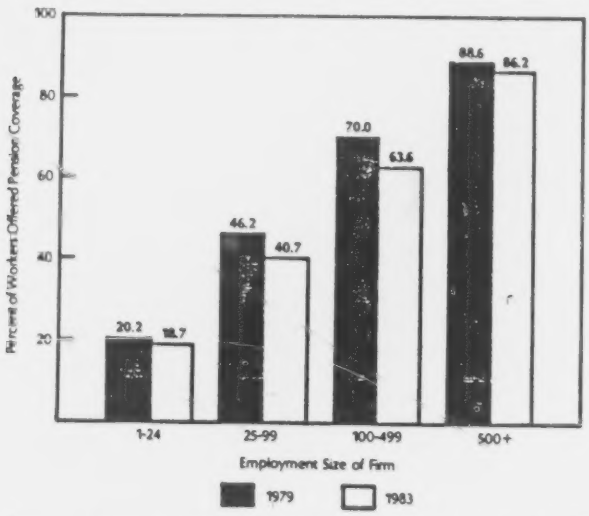
Small business delegates to the 1986 White House Conference on Small Business recognized the importance of the private retirement system in helping small businesses to remain competitive. The delegates called for a 5-year moratorium on pension law changes, unless the changes promote parity in the treatment of large and small plans (i.e. repeal the top-heavy rules), reduce pension filing and paperwork requirements or increase the benefits available from retirement plans. S. 1426 is a step in the right direction.

1. The Need to Expand the Voluntary Pension System

The primary goal of S. 1426 is to expand pension coverage in small firms by providing tax incentives and reducing some of the current regulatory burdens. Research conducted for SBA reveals the lesser prevalence of retirement plans in small firms and confirms S. 1426's approach as a means of resolving the problem.

The relatively low level of worker coverage in small business primarily stems from the lack of retirement plans in small firms, rather than from the failure of existing small business pension plans to actually cover workers and deliver benefits. To no one's surprise, the likelihood of an employer sponsoring a plan increases with firm size. Fewer than 1 of 5 workers in firms with less than 25 employees is employed in a business that offers a retirement plan, as compared to 5 of 6 workers employed in businesses with over 500 employees. See Table I.

Table I *Percent of Wage-and-Salary Workers in Firms Offering Pension Plan Coverage by Employment Size of Firm, 1979 and 1983*



Source: U.S. Department of Commerce, Bureau of the Census, *Current Population Survey*, May 1979 and May 1983, unpublished data.

There are a number of reasons why plan sponsorship is low among small businesses. First and foremost, many small businesses cannot afford pension plans. A small employer's profits may be insignificant, unstable, or non-existent, and business owners may prefer reinvesting earnings in the business. When funds do become available to spend on employee benefits, research indicates that small employers are more likely to purchase health insurance for their workers than initiate pension

plans.[1] Other reasons for the relatively low incidence of pensions in small firms are the disproportionately high cost and complexity of plan administration, the limits on benefits that business owners can obtain from plans and the constantly changing legal and regulatory environment for pension plans.[2]

Since 1982, there have been four new laws that have required major revisions to retirement plans: the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) P.L. 97-248, the Deficit Reduction Act (DEFRA) P.L. 98-369, the Retirement Equity Act (REA) P.L. 98-397, and most recently the Tax Reform Act of 1986 (TRA) P.L. 99-514. These laws sought to improve the pension benefits and security of younger workers, women, shorter-term employees, lower paid workers and workers' spouses. The apparent, but unintended, effect of the laws, however, is to impede new plan formation and encourage the termination of existing retirement plans.[3] Not only have the legal changes required costly plan amendments, they have significantly increased complexity and on-going plan administration costs and curtailed the benefits available to business owners. Frequent legal changes, which require costly plan amendments, funnel dollars which could be used to provide benefits into plan

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[1]See Bell, James, "Coverage, Characteristics, Administration and Costs of Pension and Health Care Benefits in Small Businesses," prepared for SBA Office of Advocacy, March 1984, p. 17 (hereinafter "Pension Coverage in Small Business."

[2]See generally Bell, James, "Pension Coverage in Small Business," and Justin Research Associates, "Issues Relating to Small Business Pensions," submitted to U.S. Small Business Administration, Office of Advocacy, May 1985.

[3]Employee Benefit Research Institute analyses of Labor Department data and IRS determination letter statistics indicate that net plan growth has slowed since 1981. See Employee Benefit Research Institute, "Employee Benefit Notes" September 1986, p. 5. Anecdotal information provided to the Small Business Administration by service providers of small retirement plans suggests that terminations have increased and are linked to the rash of new laws. There are no IRS or Labor Department data analyzed providing information on plan formations and terminations by size of firm.

administration. The massive changes to pension plans required by TRA, in conjunction with TRA's lower individual tax rates, are expected to severely restrict small plan growth and increase terminations.

In short, the costs are becoming too high and the benefits too low for many small employers to be interested in sponsoring pension plans. While pensions have always been a sort of "luxury" item for small businesses, plans are becoming even more unaffordable and impractical for small employers. Assuming changes in pension law continue on this course, imposing new costs and limitations on plans almost on an annual basis, terminations by small employers can be expected to increase. Unfortunately, because of these recent changes in the law, the gap between large and small firms in the provision of pensions is likely to grow.

Growth of the sector of employees not covered by pension plans ultimately could lead lawmakers to view a mandated pension system as a solution, as the current debate on mandated health insurance demonstrates. Ironically, the failure of government regulation and policy to expand the voluntary pension system would be a significant factor in creating an environment in which mandated retirement benefits would be considered a solution.

The small business community believes that it is necessary to promote the voluntary pension system by restoring tax incentives and eliminating burdensome and marginally useful regulation. S. 1426 adopts this approach and, hopefully, signals the start of a more positive environment for small business retirement plans.

2. Provisions of S. 1426

Repeal of the Top-Heavy Rules

S. 1426 repeals the "top-heavy" rules -- a complicated set of regulations that apply to virtually all small retirement plans. Enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982, the top-heavy rules were intended to ensure a fair distribution of pension benefits among all plan participants. In practice, however, the rules have proved to be complicated and costly to administer and a disincentive to small employers to sponsor retirement plans.

Specifically, the rules apply where retirement plans predominantly benefit "key employees" -- a situation which frequently occurs in small businesses because of the relatively high ratio of business owners to lower paid employees. The rules limit the benefits available to key employees and require additional benefit protections for rank-and-file workers.

The Office of Advocacy has been actively involved in examining the need for top-heavy rules. We have funded research and sponsored a policy forum on the issue. The small business community also supports repeal of the rules: delegates to the 1986 White House Conference on Small Business, the National Federation of Independent Business (NFIB) and the Small Business Legislative Council (SBLC) have all listed repeal of the top-heavy rules as a legislative priority.

While small business pension advocates have long questioned the need for special top-heavy rules on top of all normal pension requirements, the question of the rules' continued need has become even more compelling in light of the pension provisions of the Tax Reform Act of 1986 (TRA). TRA extends a number of

top-heavy concepts to all retirement plans, raising the issue of the rules' utility and whether uniform rules should apply to all plans, regardless of size.

Table II provides a side-by-side comparison of the top-heavy rules and similar Deficit Reduction Act (DEFRA) and TRA provisions. As the table illustrates, most differences between the rules for top-heavy and nontop-heavy plans have been negated by laws enacted since TEFRA; however, small differences in vesting and minimum benefit/integration requirements continue to exist.

While the top-heavy vesting schedules and minimum benefit requirement for defined benefit plans can, in some top-heavy plans improve the benefits of lower-paid workers,[4] these added benefits, where they exist, may not be so significant as to justify maintenance of the entire top-heavy regulatory structure. There needs to be a balance between delivering benefits to employees and simplifying and reducing the cost of providing benefits. For the small business owner, the current balance may be against sponsoring retirement plans.

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[4]See Calimafde, Paula "Impact of the Top-Heavy Rules on Small Business Retirement Plans: Do the Costs Outweigh the Benefits Following the Tax Reform Act of 1986?," prepared for U.S. Small Business Administration, Office of Advocacy, January 1987. The report concludes that the top-heavy 2 percent minimum benefit for defined benefit plans can improve benefits for non-key employees where non-key employees are relatively young (under age 35) and key employees are very highly compensated (earn over $150,000).

TABLE II- SIDE BY SIDE COMPARISON OF TEFRA, TEFRA, DEFRA AND TRA

	TEFRA	DEFRA	TRA 1986	POST 1986 EFFECT OF TOP-HEAVY PROVISIONS
I. Definition of Key-ee	Any ee who in the plan year or preceding 4 years was 1) an officer, 2) 5% owner, 3) 1% owner with 150,000 annual compensation, or 4) ees owning the 10 largest interests in the employer	Misc. clarifications and revisions, i.e. top 10 ees: a key-ee if annual compensation exceeds $30,000; officer not key-ee if compensation is less than $45,000	Any ee who in the plan year, or preceding year was: 1) an officer with compensation exceeding $45,000, 2) in the top 10% of ees who received more than $50,000 in compensation, 3) a 5% owner, or 4) an ee with compensation exceeding $150,000 [Yrs after 12/31/86]	Key-ee concept will coexist with concept of highly compensated ee
II. Top-Heavy Rules A. Vesting Requirements	100% vesting after 3 years of service or 6 year graded vesting		100% vesting after 5 years of service or 7 year graded vesting (applies to all non-top-heavy plans) 100% vesting with 2 year eligibility (applies to all plans) [Yrs. after 12/31/88]	De minimis
B. Minimum Benefits				
1. Defined Benefit Plans	2% of pay per year of service not to exceed 20%		No excess only plans allowed. All plans must provide some benefit - integration w/Soc. Sec. cannot absorb whole benefit. Max. Benefit in D.B. phased in over 10 years of participation	2% D.B. min. still "better" in some cases than new integration provisions
2. Defined Contribution	Lesser of 3% of non-key-ees compensation or % received by key-ees	Inclusion of salary reduction contributions in determining top-heavy		Insignificant in D.C. context

Abbreviations: "ee" stands for employee(s) "Soc/-Sec." stands for Social Security "D.B." stands for defined benefit "D.C." stands for defined contribution "Yr(s)" stands for year(s) "min" stands for minimum

(Table IICont'd Page 2)

	TEFRA	DEFRA	TRA 1986	POST 1986 EFFECT OF TOP-HEAVY PROVISIONS
		Status and minimum benefit	[10 yr. phase-in Yrs. After 12/31/86] [integration provisions 12/31/88]	
C. Cap on Compensation	$200,000 cap on compensation taken into account		$200,000 limit applies to all plans [yrs. after 12/31/88]	None
D. Combined Plan Limit	1.0 limit for companies who provide both D.B. and D.C. plans Top-heavy plans, other than super top-heavy plan, can "buy" 1.25 limit by providing additional 1% minimum benefit in D.B. and D.C. Plan		15% penalty on excess retirement plan assets applies to all ees covered by any type of retirement plan [Distributions after 12/31/86]	Not clear whether 15% penalty will replace in operation the 1.0 limit
III. A. 10% Penalty on Premature Withdrawals (received prior to age 59-1/2)	Applicable only to key-ees [12/31/83]	Applicable to 5% owners [Yrs. after 1984]	Applicable to all distributions (Taxable years after 12/31/86]	None
B. Required Distributions	Non-key-ees interests must be distributed the later of when ee reaches the age of 70-1/2 or when the ee retires. Key-ees interests must be distributed when ee reaches age 70-1/2. [Plan Yrs. after 12/31/83]	5% owner is substituted for key-ee in TEFRA language [Yrs. after 12/31/84]	Interests under all plans must be distributed before April 1 following the calendar year in which the ee reaches the age of 70-1/2 [Distributions after 12/31/88]	None

*Excerpted from Calimafde, Paula, "The Impact of the Top-Heavy Rules on Small Business Retirement Plans: Do the Costs Outweigh the Benefits Following the Tax Reform Act of 1986?," prepared for the U.S. Small Business Administration, Office of Advocacy, January 1987

particularly defined benefit plans. Repealing the top-heavy rules could be an important first step in unifying, simplifying and promoting pensions for small employers.

As Senator Heinz noted in introducing the Retirement Income Policy Act of 1985, the precursor of many of the TRA pension provisions:

> "Although this legislation has proposed uniform rules for retirement and nonretirement plans in general, one set of unique rules -- the so-called top-heavy rules -- remain left untouched by this bill. We recognize that it is awkward to leave a series of special rules based largely on plan size in place in a bill purporting to establish consistent policy for employer-sponsored plans. Once the kinds of benefit protections provided to employees of small firms through the top-heavy rules are adopted more broadly, these special rules and the elaborate definitions of top-heavy plans should be dropped from the Internal Revenue Code.[5]

Administrative Cost Tax Credit

S. 1426 allows a tax credit for small employers maintaining retirement plans. The credit is intended to help offset the disproportionate cost of administration for small plans. To be eligible for the credit, employers cannot have more than an average of 100 workers, and must accelerate vesting for employees, with gradual vesting over the first three years and complete vesting at the end of the fourth year of service. The amount of the credit is the lower of $3,000 ($4,500 in the case of defined benefit plans) or 14 percent of the deduction for pension contributions attributable to non-highly compensated employees.

Of course, new tax credits do raise major revenue concerns, however, the small business community supports the use of tax

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[5]99 Cong. Rec. S. 13802, October 22, 1985.

credits to stimulate retirement plan coverage in small firms. The tax credit in S. 1426 is designed to reward employers already maintaining plans that provide minimum benefit securities to employees.

Pension Paperwork

An important goal of S. 1426 is to simplify the reporting requirements for retirement plans. In research conducted for SBA, small employers ranked reporting and disclosure requirements as the most burdensome aspects of all pension regulation.[6] S. 1426 is aimed at reducing this burden for plans with under 100 participants by eliminating the requirement to provide participants with Summary Annual Reports (SARs) and by requiring the Secretaries of Labor and Treasury to simplify filing requirements so that the forms are understandable to nonpension experts.

Our research suggests that the Summary Annual Report is not heavily utilized by participants because it contains financial information on plan operation which is not of interest to most employees.[7] Because the complete annual report is made available to participants, the SAR could eliminate without jeopardizing the Employee Retirement Income Security Act's (ERISA) disclosure goals.

Because approximately half of small employers administer their own retirement plans,[8] the goal of greatly simplifying filing

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[6]See Justin Research Associates, "Pension Laws and Regulations Affecting Small Business Plan Decisions," submitted to U.S. Small Business Administration, Office of Advocacy, April 1986 (hereinafter "Pension Laws and Regulations").

[7]See Justin Research Associates, "Pension Laws and Regulations."

[8]See James Bell and Associates, "Pension Coverage in Small Business."

requirements may be a worthy one. As you may know, the Department of Labor, Internal Revenue Service, and Pension Benefit Guaranty Corporation have already initiated a rulemaking to simplify the Form 5500 series. We have provided formal comments to the agencies and are encouraged that meaningful revisions can be achieved.

Nondiscrimination Rules

S. 1426 would delay by three years the effective date of the nondiscrimination rules imposed on health and other welfare benefit plans by TRA. A three-year delay could assist small employers in complying with these complex rules. Currently small businesses are struggling to understand and comply with the new continuation coverage requirements of the Consolidated Omnibus Budget Reconciliation Act (COBRA). In addition, many small firms are experiencing the added costs to health plans of specific state mandated health insurance benefits. A delayed effective date for the TRA nondiscrimination rules would help to spread out these newly imposed regulatory costs.

3. Conclusion

To expand retirement coverage of our Nation's workers, it is essential to increase plan sponsorship where it does not currently exist -- among small businesses, particularly those with under 100 employees. Because the decisionmaker with respect to employee benefits in the small business is the business owner, incentives to sponsor plans must be targeted to business owners. Broad-based benefit delivery -- the primary goal of our pension laws -- can never be achieved if the costs of providing benefits to workers are too high, relative to the benefits available to business owners.

S. 1426 recognizes the essential voluntary nature of the private retirement system and, hopefully, signals the beginning of a new sensitivity to small business.

Senator PRYOR. Mr. Swain, thank you, and you were right on the money. [Laughter.]

Senator PRYOR. You set a good example for all of our witnesses to follow. [Laughter.]

Senator PRYOR. Mr. Swain, I will have one or two questions in a few moments. We will allow the other panelists to go forward.

Ms. Calimafde?

STATEMENT OF PAULA A. CALIMAFDE, ESQUIRE, PRESIDENT-ELECT, SMALL BUSINESS COUNCIL OF AMERICA, WASHINGTON, DC

Ms. CALIMAFDE. Thank you, Mr. Chairman.

It is a privilege to be here today to represent small business. I am the president-elect of the Small Business Council of America, which is an organization which represents over 1500 businesses in the country, all small business and all of which represent or sponsor private retirement plans. I am also here on behalf of the SBLC, the Small Business Legislative Council, which is a coalition of 90 trade and professional associations and represents the interests of over 4 million small businesses, which also cover the spectrum of all types of businesses.

I am also here in the capacity of representing the more than 1800 small business owners who were delegates to the White House Conference of Small Business in 1986. I served as the chairman of the Payroll Cost Section of that Conference, which covered employee benefits and private retirement plans. The delegates formulated 60 recommendations which they gave to Congress and the President.

The 20th recommendation was that Congress must actively promote the private retirement system, and one of the ways they suggested it be promoted was to repeal the top-heavy rules.

The second recommendation of that conference was that there should be no mandated employee benefits.

Today I want to focus on the forest instead of focusing on the trees. I will be making some harsh statements about the health of the voluntary private retirement plan system and about how the system got there, and I can imagine you would be saying, "Well, who is she to make these kinds of comments?"

I can tell you that I don't know all of the answers, obviously, but as a practitioner in this area for more than 10 years and after talking to many, many small business owners, I can tell you that I know first-hand the problems of the system.

A question that your legislation addresses is: Why don't more small businesses cover employees with private retirement plans? It is a voluntary system; why doesn't the system seem to be working in the small business area?

First and foremost, apparently there are about 26 percent of all small businesses that do cover their employees with retirement plans. And I think if a study were done—I have been unable to locate such a study, but if it were done—we would find that these plans are extremely generous to their employees. And I would guess that they are far more generous than the average plan spon-

sored by a big business, particularly in the labor union context. Why don't the remaining 74 percent cover their employees?

I think there are two main reasons. One is profitability. A small fledgling business cannot afford a retirement plan. It is usually in a make-it-or-break-it situation for a number of years; it is a "lean" and mean organization. Once the business gets going and the profits don't have to be reinvested, them the company can start talking about private retirement plan.

The second reason, which I think is even more important—because there are an awful lot of successful small businesses in this country, which is why small business is the leading sector for providing new jobs for our nation's employees—is because the system is absurdly complicated, arcane, totally out of whack.

Harsh statements? I think they are true. As a practitioner in this area, every time I see the latest ruling or notice from the Service, which can be 200 pages or more, or the latest Tax Act, I sit and think, "Why am I in this area of law?" And if that is what I think as a tax specialist, I can't imagine how a small business owner can keep up with this. In fact, I dread those days when I have to explain to small business owners that there is another new law they have to comply with. They listen to me and they say, "What are you talking about? This is technical mumbo-jumbo." And to a large extent, they are right.

Now, how did this happen? How did we end up with a system which should be based on clear goals, end up so mucked up with so many rules and regulations that even a specialist can't figure it out?

I think it happened because most Congressmen are pulled in so many directions with so many major things happening in the world that they just couldn't watch over the private voluntary retirement plan system. It is a difficult area because it is so hard to understand. You stand out in stark contrast to many of your colleagues as someone who understands the system and is taking a major step forward to correct the problems, with simplification, rationalization, and stabilization.

I believe that if small business owners, managers of pension plans, as well as anyone else who is interested has technical expertise in this area, and most importantly practical experience, were put in a room, we could devise a system that is simple, that is understandable, and that is stable. And I think once those things happen, small business would embrace the system.

So, Mr. Chairman, I think your legislation speaks for itself as a major step forward in this process.

Thank you.

Senator PRYOR. Thank you. By the way, I think you may have had a longer statement, and the entirety of your statements will be put in the record.

Ms. CALIMAFDE. Thank you.

[Ms. Calimafde's prepared statement follows:]

STATEMENT OF PAULA CALIMAFDE ON BEHALF OF
THE SMALL BUSINESS COUNCIL OF AMERICA, INC.
AND THE SMALL BUSINESS LEGISLATIVE COUNCIL
BEFORE THE SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS
AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE
OF THE COMMITTEE ON FINANCE
UNITED STATES SENATE

October 23, 1987

Mr. Chairman and Members of the Committee:

My name is Paula Calimafde. I am the President-Elect of the Small Business Council of America, Inc. (SBCA). The Small Business Council of America is a non-profit organization which represents the interests of small business organizations on Federal tax matters. SBCA has a membership of over 1,500 businesses, consisting of retail, manufacturing and service organizations located in 47 states most of which maintain employee benefit plans. The Small Business Legislative Council (SBLC), on whose behalf this statement is also made, is a permanent, independent coalition of 90 trade and professional associations that share a common commitment to the future of small business. The SBLC represents the interests of over 4 million small businesses in manufacturing, retailing, distribution, professional and technical services, construction and agriculture. A list of the members of SBLC is attached to the end of this prepared statement. I am also speaking on behalf of the Small Business Delegates to the 1986 White House Conference on Small Business at which I served as the commissioner of the Payroll Cost Section. This section covered employee benefits and the private retirement system.

The 1,813 delegates to the White House Conference on Small Business from across the country formulated for the President and the Congress 60 detailed policy recommendations. The 20th recommendation reads as follows: To promote the retirement security of our nation's employees, Congress must support and promote the continued viability of the private retirement system in the small business community. In support of this goal, there must be a five-year moratorium on further changes in our private

retirement plan laws except for the following changes which we recommend: (a) promote parity between large and small plans and between private and public sector plans. (b) simplify filing requirements and paperwork. (c) increase contribution benefit limits, including 401(k) plans and IRAs, to be at least as great as the pre-1986 tax reform act limits....

The number two recommendation reads as follows: There should be no government mandated employee benefits ....

Expansion of the Voluntary Private Retirement System Imperative

Senator David Pryor, the Chairman of this Subcommittee, has recognized that even though the small business sector has been responsible for creating the largest share of new jobs in our economy that this same sector is less likely to provide retirement benefits to its employees. Senator Pryor states that approximately 19% of workers in firms with under 25 employees work for employers that offer pension coverage as compared to 86% in firms with over 500 workers. There are two main reasons why small business does not sponsor retirement plans to the same degree as big business. First, a small business during the first several years of its existence usually cannot afford to provide a retirement plan. Starting up a small business is a high risk venture. A small business is often in a make it or break it situation for the first several years of its existence. Unfortunately, as we all know, many of these small businesses never do make it. Clearly profits in the beginning of a business are unstable or nonexistent. Profits that do exist must often be immediately reinvested in the business. Sometimes a small business stays in this condition for its entire duration.

Secondly, there is little incentive to enter into the private retirement plan system due to the ever changing laws with their absurdly technical requirements. A small business usually cannot afford an in-house employee benefit administrator who is able to administer properly the numerous forms and requirements.

We fully realize how serious a matter it is to label the private retirement system as arcane and absurd. We believe that such a characterization is fully grounded in reality. It is the result of a few key individuals who have good intentions and good technical expertise but no practical experience so that the impact of their constant changes on an actual company who has to administer the plan is not understood at all. An example of how out of whack the system is reflected in the following facts:

o On July 27, 1987, more than 200 pages of regulations were issued by the Treasury Department on the single issue of minimum distribution requirements for retirement plans under Internal Revenue Code ("IRC") §401(a)(9).

o The Tax Reform Act of 1986 ("TRA '86") contained nearly 15 pages of statutory provisions dealing with the same subject of distributions. This does not include the new tax on excess distributions and loans. The Blue Book explanations of these same provisions ran more than 20 pages. Since 1974 restrictions on distributions have been significantly increased by the following: (a) qualified joint and survivor annuity requirements under IRC §417, (b) qualified domestic relation orders requirements under IRC §414(p), (c) 10% premature distribution penalty under IRC §72(t), (d) 15% excise tax penalty on excess retirement distributions under IRC §4981(a) or §4981, and (e) 50% minimum distribution excise tax under IRC §4974.

These changes and additions to this one small section are an accurate reflection of the entire retirement plan area. Specialists in this area believe the cause for these incredibly complex changes is that elected Representatives in Congress are pulled in so many directions that they cannot find adequate time to understand and protect the private retirement plan system. Without knowledge they are not able to act as a moderating and practical influence.

The Small Business Retirement and Benefit Extension Act is a long-overdue welcome exception. The general thrust of the legislation is welcome and needed. The legislation repeals discriminatory provisions towards small business, cuts out redundant limitations, defers the effective date of legislation that is absurdly complex and which will hopefully be rewritten in a manner capable of being understood by specialists. Perhaps most importantly, the legislation requests the Secretary of Treasury to simplify the present forms filled out by small business. These forms are so complicated that pension administrators can hardly fill them out let alone the owner of a small business. There is no reason why these forms cannot be rewritten in English.

It is imperative that the retirement security of all American workers be improved. Social Security was intended to be a supplement to retirement savings. Small business will voluntarily sponsor private retirement plans, if the system is corrected and simplified. The Small Business Retirement and Benefit Extension Act is a major step forward to improving the voluntary private system. The private retirement system is based on incentives. Over the last four years, there have been four major laws enacted significantly affecting retirement plans:

1. The Tax Equity and Fiscal Responsibility Act (TEFRA),
2. The Deficit Reduction Act (DEFRA),
3. The Retirement Equity Act (REA), and
4. The Tax Reform Act of 1986 (TRA '86).

The primary goals of these laws were to raise revenue, to protect spousal rights, and to increase coverage in benefits for staff employees while decreasing benefits for the highly compensated, particularly in the context of small to mid-size plans. The added cost and complexity to retirement plans and the tendency of frequent legal changes have discouraged plan formation and encouraged termination. This increased complexity and additional administrative burdens has come at a time when

the incentives for the key managers and owners of a small business have been severely slashed. Sadly the administrative costs of complying with the top-heavy rules, as well as all the other changes mandated by new legislation, do not benefit either the employees or the employers. These are dollars paid to pension administration firms, lawyers and accountants, that by and large might have been saved or better spent if there were a simpler and more stable set of pension rules.

Alternatives to the Private Retirement System

SEPs

Some opponents to the private retirement system say that it has failed in the small business context and that vehicles such as Simplified Employee Pension Plans (SEPs) are the answer to the problem of coverage of small businesses. This type of answer is proposed by someone with little knowledge of small business owners and small businesses. Small businesses are conceived and driven by entrepreneurs. They are people who do not turn over their affairs to banks or other institutions, rather they are people who participate in and watch over every detail of their business.

The very nature of a SEP which requires the administration and the holding of funds by a bank or insurance company or other institution is the death knell of SEPs for most entrepreneurs.

Mandated Benefits

In the last few years a new concept has been promoted which is antithetical to the free enterprise system. The mandated benefit concept is one which says let's give a very little benefit to all people rather than allowing for flexibility and meaningful benefits. There are several problems with the mandated benefit concept in the retirement plan area. First, a small business which cannot sponsor a retirement plan because it is a fledgling business with erratic or nonexistent profits cannot afford to carry a mandated retirement benefit and perhaps a mandated health benefit and perhaps a mandated parental leave

benefit. The cost of doing business may just prove to be too high. The Nation, however, as a whole, will suffer when a brilliant idea embodied by some small business goes down the tubes because it was forced to offer mandated benefits when it did not have the resources.

Second, a mandated retirement benefit by its terms is a supplement to Social Security which was designed to be a supplement to retirement savings. The system would have one supplemental benefit combined with another supplemental benefit and virtually no one would have retirement security. In the retirement area the government has, to some extent, determined that its proper role is to be socialistic and big brotherish. This is reflected in forcing distributions as joint and survivor annuities and in attempting to expand coverage while reducing the retirement benefits for all employees.

If one looks to what makes free enterprise great and the small business entrepreneur great, it is to a large extent its competitive "lean and mean" nature. It is symbolized by people working hard to earn their own benefits. The mandated benefit provides no moral incentive and no mental incentive and should have no place in our free enterprise system. Many of the so-called mandated benefit proposals and some of the portability proposals suggest that a new or old government agency should hold retirement plan funds. Small business is against establishing another government agency or utilizing an existing one to set up another retirement system to parallel Social Security.

Can The Private Retirement System Work On A Voluntary Basis?

Demographic trends will compel increased retirement plan coverage by small businesses. A current trend facing employers is the aging of the population. The percentage of the population 65 years and over has grown from 10% in 1970 to 12% in 1985 and is projected to go to 13% by the year 2000. In 1970, approximately 20 million Americans were age 65 or older;

by the year 2000, that number is projected to be approximately 35 million. Further, several economists predict that employers will be facing a labor shortage as we approach the year 2000. An estimated 90% of the work force in 1990 and 75% of the work force in the year 2000 is already in the labor force today. By 1990, over half of all workers will be parents with children under 18, and half of the labor force will be women. Employers seeking to attract the best workers will in all likelihood have to reevaluate the benefits they offer. This may have a particularly significant impact on small businesses, which employ 60% of all employees and 40% of all women employees.

If actual practitioners in the retirement plan area, small business owners, managers of large business plans as well as other people with knowledge of the business world and the retirement plan system were put in a room together, it is highly probable that they could devise a retirement plan law that made sense, was simple to administer and prevented abuses in the system. It is essential that time be spent now to correct this system and that experts in the area with real practical experience be utilized to simplify and rationalize the system.

Once the legal and regulatory environment for retirement plans was simplified, rationalized and stablized, small business owners would once again be willing to enter the retirement plan system. A voluntary system has to be driven by the engine of incentives. When the costs are too high and the benefits too low the voluntary system cannot attract employers.

Expansion of Cafeteria Plans Under Section 125

While the thrust of this legislation is aimed at retirement plans, we believe the concepts embodied in it should be extended to the delivery of employee benefits by small business. For generations, the public policy of the United States and the employment practices of the nation's businesses, large and small have presumed a worker with a spouse at home to care for children and sick or aging parents. However, America is no

longer the land of the traditional family -- the married bread winner with a wife at home. Fewer than 10% of American households fit the traditional mold. Women with children have moved into the work force in enormous numbers and the number of single or divorced parents -- both male and female -- has increased dramatically. More than half of the 45.6 million children in two parent families have both parents in the work force. Single parent households have increased to the point where over half of the nation's children will spend of their lives as members of a single parent household. At the same time, the role of men is changing, as more men chose to be more involved in their children's upbringing. The majority of American parents work and raise children.

A cafeteria plan, sometimes called a flexible benefits plan, allows employees to pick the benefits they want. A flexible benefits plan allows each employee to select on an individual basis from a variety of benefits which include: health and dental insurance, dependent child care reimbursement, medical care reimbursement, additional leave time, life insurance and disability income insurance. For example, a pregnant employee could select additional vacation time for maternity leave, dependent child care (which would allow the cost of child care to be paid for on a pre-tax basis) and disability income insurance to cover normal maternity leave. Another employee with child approaching college age might prefer to pick up additional group term insurance. An older worker might prefer to have additional medical expenses not covered by insurance paid for on a pre-tax basis.

The tax laws should encourage, rather than actively discourage, the establishment of flexible benefit plans by small and mid-size employers. The discrimination tests in the flexible benefit plan are unduly harsh and complicated. Each benefit offered under the plan must meet separate discrimination tests and the flexible benefits plan as a whole must meet

separate tests. The most extreme example of this complexity is found in the dependent care area where in order to qualify as dependent/child care program a company must make sure the plan qualifies under six separate discrimination tests! We would encourage your subcommittee to develop a single clear discrimination test and/or some safe harbour tests so that this type of plan could become workable for small to mid-size businesses. This would be a significant step towards encouraging smaller businesses to provide broader benefits and providing the benefits our changing work force requires.

In conclusion, the small business community applauds your efforts to understand and remove some of the impediments to private retirement plan sponsorship by small companies. The Small Business Retirement Benefit Extension Act is the first major piece of legislation in years for small business that actively promotes private retirement plans. It encourages the voluntary private retirement system for small business by repealing the top-heavy rules, allowing a tax credit to businesses maintaining plans with fewer than a hundred employees and mandating reduction and simplification of pension paper work requirements. Perhaps, most importantly, the legislation tackles head on the over regulation of the system and the negative attitude fostered by some legislators that it is nothing more than a major tax loop hole for the entrepreneur. If the system is simplified and rationalized, it will be embraced once again by small business and meaningful benefits will flow to all of its employees.

Senator PRYOR. Dr. Andrews.

STATEMENT OF DR. EMILY S. ANDREWS, RESEARCH DIRECTOR, EMPLOYEE BENEFITS RESEARCH INSTITUTE, WASHINGTON, DC

Dr. ANDREWS. Good morning, and thank you.

First I would like to mention that the Employee Benefit Research Institute is a nonprofit, nonpartisan public policy research organization. We attempt to provide information useful for the formulation of public policy. However, we do not take positions on public policy issues.

I am pleased to provide information today on pension plan coverage among small employers in the United States. I have submitted written testimony to the subcommittee and will summarize the major points of that testimony now.

In 1983, roughly 44 percent of all nonfarm employees worked for an employer who did not provide a pension plan. The majority of these workers were employed by firms with fewer than 100 employees. My testimony discusses small employer pension coverage, using statistics based on several data sources that have been made available recently.

Small firms provide important employment opportunities for much of the population. In total, 46 percent of all civilian nonfarm employees worked for firms with fewer than 100 workers. Small employers may be found in all industries, although workers in smaller firms are less likely to work in manufacturing and more likely to work in services.

Because small employers hire workers in occupations that parallel the industries in which they work, the occupational distribution of workers in small firms is different from that of large firms, and large employers are more likely to have unionized workers. Very small firms—less than 25 workers—engage a smaller percentage of prime-age full-time, full-year workers.

These differences suggest that there may also be differences in their wages and benefits. In fact, one of the most consistent findings of researchers is that small firms tend to pay less than large firms. In addition, workers in small businesses are generally less likely to receive employee benefits than workers in large businesses.

Different types of retirement plans are also provided by small and large employers. These differences suggest that economic factors may be important influences on plan provisions.

In general, employers will provide pensions if the benefits from establishing a plan are greater than the cost of providing the plan. Yet, the administrative costs to plans for small employers are likely to be greater than those for large employers. Presumably, the economic benefits of having a plan would also have to be greater for small employers than for large corporations; and tabulations indicate that employees who work for small firms with pension plans are indeed different than employees who work for small firms without pension plans.

The data I have looked at suggests that the provision of pensions by employers with 100 or fewer employees is influenced by business considerations. Consequently, public policy options that would

reduce the cost of providing a plan or increase the benefits of pension plan provisions for small employers would encourage pension coverage. Yet, as in any area of government regulation, concerns about the efficacy of economic incentives need to be balanced against the potential for abuse. In this area, as in so many others, better facts and figures can be instrumental in achieving that balance.

My written testimony provides more statistical information about small employers with and without pension plans. I would be happy to answer any questions you might have about these figures or about other aspects of pension coverage among small employers, and I would like to thank you for the opportunity of appearing before you this committee.

Senator PRYOR. Thank you, Dr. Andrews.

[The prepared statement of Dr. Andrews follows:]

Pension Coverage Among Small Employers: Facts, Figures, and Analysis

Statement of
Emily S. Andrews, Ph.D.
Research Director
Employee Benefit Research Institute

Introduction

In 1983, roughly 44 percent of all nonfarm employees worked for an employer who did not provide a pension plan. The majority of these workers were employed by firms with fewer than 100 employees. Research has shown that the most important determinant of pension coverage is firm size. If small employers provided pensions in the same manner as larger employers, many millions of workers would have a pension plan. While studies have indicated how small employers affect pension coverage, relatively little research has been conducted to explain why many small employers do not provide pension plans.

Many definitions of small business have been used, including ones relying on assets, sales, and employment. In this testimony, employers are categorized by employment size. Very small employers are those with fewer than 25 employees, and small employers are those with fewer than 100 workers. Very large employers are businesses with a work force of 1,000 or more.

This testimony discusses small employer pension coverage using statistics based on several data sources that have been made available recently. The first data set is the May 1983 Current Population Survey (CPS) pension supplement sponsored by the Employee Benefit Research Institute (EBRI) and the Department of Health and Human Services (HHS) and conducted by the Bureau of the Census. The second data set is the Small Business Administration's (SBA) match of 1979 Internal Revenue Service (IRS) tax records for corporations, sole proprietorships and partnerships to employment, and payroll data. Tabulations based on these data were first published in the SBA's 1986 report, The State of Small Business. The third primary data set is a 1985 survey of small employers that the National Federation of Independent Business (NFIB) conducted from its own membership. In addition, 1985 Bureau of Labor Statistics (BLS) data for medium and large firms is cited for purposes of comparison. Using these data sets, it is possible to draw a much clearer picture of small businesses and their pension plans.

How Important Are Small Firms?

Small firms provide important employment opportunities for much of the population. According to the 1983 CPS pension supplement, 46 percent of all civilian, nonfarm employees worked for firms with fewer than 100 employees. Furthermore, over two-thirds of those workers worked for firms with fewer than 25 workers. Thus, nearly one-third of all workers (31 percent) worked in very small firms with fewer than 25 employees. At the other end of the spectrum, over one-third (36 percent) of all workers worked for very large firms -- those with 1,000 or more workers. Fewer workers worked for medium-sized firms. Less than one-fifth (19 percent) of the labor force worked for employers with 100 to 1,000 workers.

Despite considerable fanfare to the contrary, the employment share of small firms has probably remained relatively stable in recent years. The percent of private, nonfarm workers in firms with fewer than 100 employees in 1983 essentially maintained the earlier 1979, 46 percent rate. While shifts away from larger firms may be underway, particularly in manufacturing, a strong increase in the employment share of small firms is likely to be observed only after many years.

Nonetheless, even today most employers are small. According to 1979 tax files, 38 percent of some 2.6 million corporations had fewer than 5 employees. Furthermore, 81 percent of all corporations had fewer than 20 employees. Relatively few corporations represent medium-sized and large firms. Sole proprietorships and partnerships are even more likely to be small. Out of 9.3 million sole proprietorships, 82 percent had fewer than 5 employees and 99 percent had fewer than 20 employees. Similarly, out of 1.3 million partnerships, 59 percent employeed fewer than 5 employees and 92 percent hired fewer than 20 employees.

Small employers made a substantial, but smaller, contribution to business investment and sales compared to large employers. Corporations with fewer than 100 employees accounted for 21 percent of corporate assets and an estimated 28 percent of receipts. Large employers with 1,000 or more employees accounted for 61 percent of assets and an estimated 55 percent of receipts. Medium-sized firms with 100 to 1,000 employees held less than one-fifth (18 percent) of all corporate assets and an estimated 16 percent of receipts.

Small employers may be found in all industries. In very small firms, 10 percent of employees worked in manufacturing and 11 percent in construction. In addition, 32 percent worked in retail and wholesale trade and 38 percent in services. Slightly larger firms have a similar employment distribution but a greater proportion of manufacturing employment and a smaller proportion of workers in the service sector.

Workers in larger firms are also more likely to work in manufacturing and less likely to work in services. The share of manufacturing employment drops most sharply for firms with fewer than 25 workers. The share of service employment increases most sharply for firms with 1,000 or more workers. In very large firms, 39 percent of employees worked in manufacturing in 1983 and fewer than 2 percent worked in construction. Similarly, in very large firms, 22 percent of all workers were in the retail and wholesale trades and only 15 percent in services. Thus, employment in large firms is more concentrated in manufacturing and less concentrated in the service sector.

In sum, small employers account for a significant share of business assets, sales, and employment, and they operate in a variety of industries. Nevertheless, there are signficant differences in the structure of small and large firms. These differences have been persistent over time and probably reflect the most efficient size for different activities. The work forces of large and small employers may also be molded to particular production needs.

Does the Work Force Differ by Firm Size?

Small employers hire workers in many occupations that, in part, parallel the industries in which they work. In very small firms (fewer than 25 employees), 9 percent of all workers are managers and professionals and 16 percent are administrative and clerical workers. One-fifth of all workers in those firms are service workers; another 6 percent are construction workers and 18 percent are other production and craft workers.

The occupational distribution of small firms is different from that of large firms. In particular, large firms have a higher percentage of managers and professional workers (16 percent) and a higher percentage of clerical and administrative workers (20 percent). Although the proportion of non-owner

managers is higher in larger firms, additional data would be needed to determine whether the proportion of managers and owner-managers combined is higher. Very large firms employ a smaller percentage of construction workers (only 2 percent) and a higher proportion of other production and craft workers (27 percent). Large employers are also more likely to have unionized workers. While only 5 percent of very small firms are unionized, 31 percent of the workers in large firms are subject to a union contract.

These differences in unionization and occupation are not the only worker characteristics that differ by firm size. While firms of all sizes hire all types of workers, more teenagers age 16 and 17 and more workers over age 65 work for very small firms than for very large firms. Similarly, very small firms are more likely to hire part-time employees who work fewer than 500 hours a year.

Workers in very small firms are also less likely to stay on the job. Only 12 percent of workers in very large firms were on the job for less than one year compared to 30 percent of workers in very small firms. Employees of large firms are also much more likely to have long tenure on the job. Before the 1986 Tax Reform Act, many employers selected a 10-year vesting standard for their pension plans. The proportion of workers who would have met such a standard in large firms is higher than the proportion in very small firms. Fully 36 percent of employees in very large firms were on the job for 10 years or more compared to only 16 percent of workers in very small firms.

Thus, while workers are found in a wide variety of occupations in both large and small firms, significant occupational differences exist. Furthermore, very small firms engage a smaller percentage of prime-age, full-time, full-year workers, the type of workers that were originally the focus of the 1974 Employee Retirement Income Security Act (ERISA). In addition, large-firm workers are generally on the job longer than small-firm workers. These differences in the type of work force engaged by large and small firms suggest that there may also be differences in their wages and benefits.

A Comparison of Wages and Benefits

One of the most consistent findings of researchers is that small firms pay less than large firms. Using the May 1983 CPS pension supplement data,

average annual earnings in very small firms were an estimated $11,300 compared to an average of $20,200 annually for very large firms. This finding generally holds across all occupations. For instance, among professionals in very small firms, average earnings were $16,000 annually, whereas they reached $28,000 in very large businesses. Similarly, administrative and clerical workers averaged $9,900 annually, compared to $15,800 for similar workers in large firms. Furthermore, other survey data suggest that managers are paid more in large firms as well. Nevertheless, according to the May 1983 CPS pension supplement, individuals in certain technical and professional occupations may have higher earnings in small firms. These occupations include mathematicians and computer scientists, health diagnosing occupations (including physicians), lawyers, and judges.

Studies show that the finding of lower pay in small firms is not simply an artifact of worker differences that are hidden in aggregate job classifications. Research has shown that even when wage rates are adjusted for factors such as education, age, hours worked, union membership, and other related factors, on average, workers in small firms tend to be paid less.

Workers in small businesses are generally also less likely to receive employee benefits than workers in large businesses. Benefit provision for full-time workers in large and medium-sized firms in 1985 can be compared to that provided workers in small firms using the BLS and NFIB surveys mentioned earlier. According to these surveys, almost all large and medium firms provided their full-time workers paid vacations, while only 80 percent of the full-time employees in small firms (less than 100 employees) had paid vacations. While practically all full-time workers in medium and small companies had health and life insurance on the job, 75 percent of similar workers in small firms had health insurance and only 59 percent had life insurance.

Similar figures for pension and retirement benefits are more disparate. Acccording to the BLS data, over 90 percent of all full-time employees in medium and large firms participated in a retirement or capital accumulation plan in 1985. According to the NFIB data, only 43 percent of full-time workers in small firms were plan participants. Moreover, this figure probably represents a maximum. The CPS pension supplement for 1983 indicates that only

26 percent of full time workers in 1983 were covered by a pension plan. The IRS-SBA data match suggests that only 21 percent of firms with fewer than 100 workers took a pension deduction. The NFIB members probably represent small businesses that are relatively stable and, therefore, more likely to provide benefits.

Different types of retirement plans are provided by small and large employers. Among large employers, 80 percent offered a defined benefit plan in 1985 and 41 percent offered a defined contribution plan. Many large and medium-sized employers offered their employees both types of plans. In contrast, defined contribution plans are favored by small employers, with 65 percent of the NFIB survey respondents providing retirement benefits indicating that they provided such a plan. And half of these plans are profit sharing plans. Only 6 percent of small firms offered a multiemployer plan and 25 percent offered defined benefit plans.

Why Don't Employers Have Pension Plans?

Several related research issues are tied to an assessment of why many small employers do not provide pensions. These research issues include an analysis of why small employers pay lower wages and how pension plans act to increase productivity. Research studies have also considered whether companies can simply substitute wage payments for pension payments in their compensation packages.

Recent findings suggest that pension contributions are not simply a substitute for wages, although workers with higher earnings and those in higher tax brackets tend to appreciate some substitution toward tax-deferred compensation. Current research also suggests that wages are higher in large firms because large firms are more difficult to manage efficiently. Pensions are felt to serve a management purpose, in part, by inducing productive workers to stay on the job longer. While researchers do not completely agree about how pensions enhance productivity, there is a consensus that pensions serve an economic purpose.

In general, employers will provide pensions if the benefits from establishing the plan are greater than the costs of the plan. Yet the administrative costs of plans for small employers are likely to be greater

than those for large employers. Several studies show that costs per plan participant are smaller for larger pension plans. The 1985 NFIB data indicate that administrative costs range from an average of over $400 per participant for employers with only 3 to 4 employees to an average of $76 per participant for plans with 50 to 99 employees. Presumably, the economic benefits of having a plan would have to be greater for small employers than for large corporations.

Tabulations of the 1983 CPS pension supplement suggest that employees who work for firms with pension plans are different than employees who work for firms without pension plans. For instance, only 3.5 percent of employees working for very small firms and covered by a pension plan work fewer than 500 hours, compared to 10 percent of all workers in very small firms without pension coverage. Similarly, 83 percent of workers in very small firms with pension coverage are between ages 25 and 65, compared to 65 percent in very small firms without coverage. The average tenure of covered workers in very small firms is about 7.5 years on the job, compared to 4.3 years for those without pension coverage. These figures suggest that even small employers find it profitable to provide pensions when their work force is older, relatively stable, and presumably more productive.

In addition, the earnings of workers with pension plans, even when they work for very small employers, are higher than the earnings of those without plans. Average earnings for covered workers in small firms are $17,100, compared to only $10,100 for those without coverage. Higher income workers may be more likely to have pension coverage for two reasons. First, they may be more willing to accept deferred compensation because of their higher marginal tax rates. But, employers may also be more willing to pay more productive workers pensions in the hopes of keeping them with the firm longer.

One frequently cited reason for instituting a pension plan is that of firm profitability. Profitability might influence pension coverage for a number of reasons. A profitable firm would be more likely to be in a position to make the type of long-term committment that a pension plan implies. Furthermore, a profitable firm might also be a growing firm. The NFIB data base does not have information about profitability but provides information on sales.

Statistical analysis indicates that firms with higher sales are uniformly more likely to have a pension plan. (Research on profitability for firms with and without pensions could only be conducted through a special analysis of the SBA's IRS match file.)

Small-Employer Pensions and Public Policy

The data presented suggest that the provision of pensions by employers with 100 or fewer employees is influenced by business considerations. Consequently, public policy options that would reduce the costs of providing a plan or increase the benefits of pension plan provision for small employers would encourage pension coverage. Yet another public policy consideration has been to discourage pension plans that are simply established to shelter the income of owner-managers or other highly paid executives and partners. The data suggest that some concern about professional corporations may be warranted, as one-third of all employees with pension coverage in firms with 25 or fewer employees work in the professional service industry. This industrial category only accounts for 23 percent of workers in very small firms without coverage. A similar skew in the industrial distribution for covered and noncovered workers is not observed in other firm-size categories including firms employing 25 to 99 workers.

As in any area of government regulation, concerns about the efficacy of economic incentives should be balanced against the potential for abuse. In this area as others, better facts and figures can be instrumental in achieving that balance.

Senator PRYOR. Mr. Swain, some months ago—I imagine about six or seven months or so—I gathered a group of people representing business, small business, independent businesses, and whatever, and I stated that we were going to revisit the pension issue in the Congress this year. One side of the room groaned, and one side of the room said, "Yes, we need to do it." There was sort of a split there, I think, that first meeting we had.

A lot of the people, I think, who did not want to revisit this issue expressed their feelings based upon all of the changes, all of the new rules, regulations, new laws, tax codes, that, "We just can't absorb any more changes right now in the whole system."

My question to you is this: Should we seek at this time a legislative remedy, vis-a-vis an administrative remedy, or go some other route? What do you think is going to be necessary to constructively revisit this issue?

Mr. SWAIN. Well, Mr. Chairman, I am not at all surprised that, when you suggested that you were going to revisit the pension issue, there were indeed groans in the audience; because as all of our statements, including your opening statement, have pointed out, the track record on revisiting pension issues has been the elaboration of additional regulatory schemes.

So, I think if you ask a small business owner, "Do you want more pension regulation?" the answer is quite clearly, "No."

Indeed, to the extent that you have identified a problem, there are lots of problems with the pension system and we can't solve them all, we can't legislate enough profits for every business to establish a retirement plan. But I think that we can legislate away some of the problems that have been created. And to the extent that the top-heavy rules have created a problem, that problem needs to be solved.

I believe, personally, that the way to solve that is through legislation, not administrative action. There is a statute on the books that requires the IRS to publish certain regulations, and the IRS doesn't have a lot of discretion in some areas. I think that a law needs to be passed to, in effect, remove that statute. And to those who say, "Well, that will allow abuse of the system," I would first of all respond as Ms. Calimafde did that there is very little abuse, I think, on a comparative basis. That is more myth than reality.

But second, to the extent that there is any abuse, the provisions in the Tax Reform Act are perfectly adequate to take care of that.

So, I do think that a legislative solution is absolutely the appropriate solution to this problem.

Senator PRYOR. Ms. Calimafde, would you like to comment on that question?

Ms. CALIMAFDE. Yes, I would. I basically agree Mr. Swain. I think legislatively there are a number of areas where the rules have to be clarified. I think the top-heavy rules are one of those.

But I think that is only one step. I think we have to go back to the concept set forth in the Ten Commandments, which were clear concise rules, instead of a statute where exception after exception after exception is written into the statute.

I think the groaning during your initial meeting was due, in part to every change being perceived as bad news, harder and harder to

administer. Each time, the law gets more nit-picky types of exceptions, so that after a while it just gets gunked up.

The system is based on incentives, and to the extent that the incentives are not strong enough becuase the costs are too high, the system goes out of whack. And I think what we have got here is a system where the costs are too high primarily because of administrative costs. This is based in large part on legislation not being properly crafted by people with practical experience who understand business, and particularly, small business. But any business is running into these same problems.

Senator PRYOR. In this very room, the Senate Finance Committee put together the Tax Reform Act. It started out as tax simplification; it did not wind up that way. As all of us know, we passed the Tax Reform Act out of this very room in 1986.

What did we do? What did we do in that particular act? On top-heavy rules, what were the differences since 1986 as compared to pre-1986?

Ms. CALIMAFDE. The major changes that the act put forth was it capped the compensation of all employees at $200,000. Previously, that limitation was only for key employees under the top-heavy rules. TRA 1986 set forth an integration scheme, so that nobody, in effect, could be integrated out of retirement plans by Social Security. This means that everyone is guaranteed a minimum benefit. It is the same concept that is embodied in the top-heavy rules; it is just gotten to by a different method.

The vesting schedules were accelerated for all businesses. At this point, with the top-heavy rules, small businesses have slightly faster vesting schedules. The TRA '86 hits all businesses with accelerated vesting schedules, though small companies still have to comply with the top-heavy vesting schedules.

Senator PRYOR. In dollar terms, what did that do (1) to the small employer and (2) to the low-paid employee? What did that difference mean?

Ms. CALIMAFDE. All right. The Tax Reform Act, in the context of small business plans, hit small business primarily in cutbacks in the defined benefit plan area and significantly increasing the complexity in the defined benefit area. I believe these changes will to a large extent cause increased terminations of defined benefit plans.

TRA 1986 will also cause all retirement plans to be amended one more time, and the amendments are so significant that I think we are talking about restatements again.

I think the Tax Reform Act in the pension area has now caused a large number of specialists to just drop out, because they don't want to keep up with the area any longer.

As far as the top-heavy rules, they are still in place, and they require a 5-year look-back to determine who "key employees" are. The other rules of the Tax Reform Act are based on the concept of "highly compensated employees," which utilizes a 1-year look-back. So, the small business owner still has the harshest administrative rules to contend with, which of course increases the administrative costs.

Senator PRYOR. Dr. Andrews, I think in your statement you point out that 65 percent, or maybe over 65 percent, of the small employers with pension plans provide a defined contribution type of plan.

Now, why is it that we don't find more of those small businesses with a defined benefit program or plan?

Dr. ANDREWS. I suspect that there are three reasons:

First, defined contribution plans tend to be simpler and less expensive to administer than defined benefit plans, and so small employers who are paying lower wages and may have lower profits would prefer a defined benefit plan.

Second, many small employers select profit sharing plans, which are also considered "defined contribution plans," so they can make contributions which vary from year to year depending on the profitability of their business. This is another incentive for small employers to have defined contribution plans.

Third, research suggests that those employers with defined benefit plans which used to have longer vesting requirements also want to provide incentives for their employees to stay with the firm longer. Job tenure tends to be shorter in small businesses because of the type of work force needed and the type of business involved. And so, the longer-term commitment encouraged under defined benefit plans would be less desirable for small businesses and their employees.

Senator PRYOR. Well, we are pleased to welcome Senator Heinz of Pennsylvania, a splendid member of this committee.

Senator Heinz, do you have a statement, or would you like to ask questions?

Senator HEINZ. Senator, I have a statement, but I will put it in the record. I will ask some questions after you have finished.

Senator PRYOR. Certainly. I have concluded my questions for this panel.

Senator HEINZ. Excuse my being late; I had one other hearing this morning, Mr. Chairman. I do, by the way, commend you for holding this hearing, and I might add that holding hearings on the subject of pension generally, right now, is a very good exercise of congressional oversight, particularly given some of the nervousness that has been occasioned by the stock market fall in values and stories that have circulated as to the extent to which the fall in values may have affected or may not have affected the income security of individuals depending on those pension plans, either now or in the future.

I recognize that is not the subject of this hearing, but I would anticipate that Chairman Pryor, after he and the committee take a careful look at the top-heavy rules, would be quite cognizant of the need for us to exercise properly discrete oversight over the status of funding of pension plans in order that we may have the information as to whether or not we should proceed, for example with the elements of the Finance Committee reconciliation package, which requires a considerable acceleration of funding. That may be more necessary, or it may be less feasible.

There are a number of income security issues, therefore, that inevitably arise out of the disarray of the financial market of the last week that we had not planned to ask, but which it occurs to me, Mr. Chairman, become quite pertinent even if we hadn't anticipated them a week ago.

I look forward to working with you in whatever course of action you deem appropriate.

I do have some questions that I would like to propose to the witnesses. They are basically informational.

I am particularly interested in the problem of administrative costs, and I would like to try to get at how the administrative costs associated with pension plans differ between small and large plans. Specifically how do the percentage of costs that are administrative vary by firm size? Is there a correlation? And roughly, what are the percentages?

Do you have any information about that, Dr. Andrews, Mr. Swain, and Ms. Calimafde?

Mr. SWAIN. Mr. Chairman and Mr. Heinz, I think that Dr. Andrews has a statement that very specifically indicates that, generally speaking, the number of employees covered by small employers for pension plans is far less than the number of employees covered by larger employers.

Senator HEINZ. We know that.

Mr. SWAIN. It is difficult for statistical reasons to translate that into hard and fast numbers on the numbers of pension plans; but I guess I would defer to Ms. Calimafde, since she is a practitioner and I believe has about 500 clients that are probably primarily small to medium sized firms, as to what you really think the costs might be.

Ms. CALIMAFDE. It would be difficult to come up with a dollar value, but I would guess it ranges, for expenses that are paid outside of the business, to keep the plan in compliance with the law probably within the $500 to $1,000 range per year since TEFRA. So that TEFRA, DEFRA, REA, each one of those has caused these kinds of changes. Prior to that time it wouldn't have been that high.

There is also the ongoing inhouse cost of the office manager or whoever is administering the plan.

This is complicated, to some extent, because the Service is deluged with what it is trying to do. For instance, the other day I got a plan back that we had submitted to the Service more than a year ago. We finally gave up trying to find out where it went, after repeated inquiries, so we sent the whole plan back in to be resubmitted to the Service. Yesterday we got about a 20-page request for various what I would consider "nit-picky" types of technical changes in the plan—but the changes being requested were from the 1986 Tax Reform Act which was passed more than 6 months after the plan had originally been submitted.

It is this kind of thing that the small business owner doesn't want to pay for, and the practitioner involved doesn't want to eat the cost; but it is not that unusual a situation.

Senator HEINZ. Getting back to your $500 to $1,000 estimate, is that the extra burden imposed by the top-heavy rules? What is that number?

Ms. CALIMAFDE. I would say that is the number of having the plan administered—and I don't even want to say "properly" because there are so many traps for the unwary right now, and usually the small business is not able to have an in-house pension administrator or an employee benefits administrator. So they are relying on their advisers.

Now, you might say, "Why don't they just open a SEP, then they won't have to deal with any of this?" A SEP is a Simplified Employee Pension Plan that is sponsored by a bank or an insurance company or other institution. The reason this type of plan is not popular is because most entrepreneurs who start up a small business aren't interested in turning over their retirement plans to institutions. These are the type of people who are very actively involved in their day-to-day businesses.

Senator HEINZ. Would that $500 to $1,000 be a one-time or an annual cost?

Ms. CALIMAFDE. Well, it would have been a one-time cost; you know, when it was ERISA, it was a one-time cost. Back then it was just the questions about when someone left—how much vesting do they have, that type of thing.

Since TEFRA the plans have had to be amended. We have gotten TEFRA, DEFRA, the Retirement Equity Act, and the Tax Reform Act of 1986. That is what is going on. That is what is causing these constant changes, and that is why the costs have escalated so incredibly in the last 4 years.

Senator HEINZ. And so, to sum up, you are saying every time we change a comma in the pension law, it costs $500 to $1,000—if a small business owner is lucky, enough to figure out what we have done and what they have to do about it?

Ms. CALIMAFDE. I think it is true. It is not the comma but the repeated commas.

Senator HEINZ. If you remove a comma from certain places, it can have a big effect.

Ms. CALIMAFDE. You are right. And I so say, I think that is the cost for small business. I am sure that mid-sized and large businesses bear an even higher cost as far as out-of-pocket dollars.

Mr. SWAIN. Mr. Heinz?

Senator HEINZ. Yes.

Mr. SWAIN. May I add that that is the cost to businesses that have plans. There is another cost that I think we could not calculate—I guess an economist might call it an "opportunity cost"—and that is, there is a cost represented by employers and employees that might be covered by a pension plan but for the fact that the law and the regulations are currently so complicated that they don't even want to jump in the pool in the first place.

Senator HEINZ. Yes. I was going to get to that.

There is one other part of my question that I need your help on, and that is: Aside from the compliance costs that we have just identified, what are the annual, if you will "routine," administrative costs for a small plan as opposed to a large plan administered by IBM, stated maybe as a percentage?

Dr. ANDREWS. Could I comment on that? We have four or five studies that tell us about administrative costs on a per-participant basis, and all of the studies show that plans with more participants have lower costs per participant.

Senator HEINZ. I am not surprised at that.

Dr. ANDREWS. I provided some figures from the National Federation of Independent Businesses' survey in my testimony, but I hesitate to give you an exact figure. I would be happy to provide the numbers to this subcommittee from the other studies that I have

reviewed. The studies are not entirely comparable—one study is for State and local plans, a couple of studies, including one I did some years ago, are for multi-employer plans. Comparing two of these studies for 2 different years, I found that the administrative costs of multi-employer plans seem to have increased faster than the rate of inflation. It would be very difficult to attribute that increase to any particular factor, however.

Senator HEINZ. Would you generalize, to this extent: Recognizing that there are differences between larger and smaller employers in terms of administrative costs as a percentage of total either income or outlay, what is the range of administrative costs? And are we talking about tenths of a percent, or what?

Dr. ANDREWS. No, they are substantial. They will double or triple depending on the size of the firm.

Senator HEINZ. The NFIB data on page eight indicates that administrative costs range from an average of $400 per participant for employers with only 3 to 4 employees to an average of $76 per participant for 50 to 99 employees. That would be on an annual basis?

Dr. ANDREWS. Yes.

Senator HEINZ. Do you have reason to believe that those are fairly accurate statistics?

Dr. ANDREWS. Although we have little comparative data, they appear reasonable.

Senator HEINZ. And for a firm with, say, 500 employees, what would the administrative cost be?

Dr. ANDREWS. They would be lower, and I hesitate to give you an exact number. But let me make another point.

Senator HEINZ. I am not trying to get blood out of a stone here.

Dr. ANDREWS. All right. I will be happy to send you all of the numbers from the study. But I am reluctant to provide potentially inaccurate figures from memory.

Senator HEINZ. All right. You have been most helpful, and I thank you. If I had been here for your testimony, I might have found that earlier.

[A letter from Dr. Andrews follows:]

EBRI

November 6, 1987

Senator John Heinz
United States Senate
Committee on Finance
Washington, DC 20520

Dear Senator Heinz:

It was an honor to be invited to testify to the Senate Subcommittee on Private Retirement Plans on the '"Small Business and Benefit Extension Act of 1987" on October 23. I am pleased you found my testimony useful.

I have enclosed two short pieces which respond to the questions you raised in your letter of October 30 about (1) the administrative costs of small employers and about (2) costs associated with "top-heavy" rules.

These enclosures may be summarized as follows:

(1) The NFIB study I mentioned in my testimony is the only research I have found specifically on small employers. Figures from that study suggest that administrative costs range from over $400 per participant for very small employers to less than $80 per participant for larger small employers. The administrative costs reported by these small employers in 1985 ran about 8 percent of pension plan contributions. The enclosure I have provided on this topic shows that the administrative cost figures I cited in my testimony are roughly in concert with those found by other studies (see table 1).

(2) No aggregate data are available on the costs of compliance with specific government regulations such as the top-heavy rules. Nevertheless, it is instructive to review several studies which asked small samples of employers about what factors influence them to start a plan; what problems they may have with their ongoing plans; and why they may have terminated a plan. The responses to these studies indicate that government regulation is part of the decision making process but that other factors are involved as well. Economic theory suggests that regulatory concerns often may be interpreted to be concerns about the costs of regulation.

I would be happy to respond to any other questions you may have on this topic.

Sincerely,

Emily S. Andrews
Research Director

Attachments

cc: Sen. Pryor

Administrative Costs in Pension Plans: A Review of the Evidence*

by
Emily S. Andrews

Per capita administrative costs are known to be greater in smaller pension plans than in larger plans. A number of studies have demonstrated this point (Caswell, 1976; Mitchell and Andrews, 1981; Cooper and Carlsen, 1980; Cooper; 1984; and Pope, 1986). Four studies, those of Caswell, Mitchell and Andrews, and Cooper, investigate the administrative costs of multi-employer plans. Caswell's study focused on the construction industry and the Mitchell and Andrews study used data from the first ERISA annual report filing (the 5500 form) to investigate all multi-employer plans. Mitchell and Andrews found that holding other factors such as asset size constant, reported administrative expenses per participant declined from $138 for plans with only 100 participants to $13 for plans with 20,000 members (Table 1). The study was restricted to multi-employer plans because single employer plans were less likely to report all their expenses if a substantial portion of plan administration was performed within the company.

The Cooper study and the Carlsen and Cooper study Taft Harley plans, conducted for the International Foundation of Employee Benefit Plans, which was also based on a sample of multi-employer plans using 1978 and 1983 ERISA annual reporting forms, suggests comparable findings. Their figures indicate that for the 1978 filing, total operating costs averaged $78 per participant for plans averaging 375 participants and declined to only $26 per participant for plans with 12,000 members on average. The findings for the 1983 filing were similar but operating costs had rising considerably. Costs averaged $170 per participant for plans averaging 375 participants compared to $56 per participant for those averaging 12,000 members. Costs for the larger category increased 115 percent while those for the smaller category increased 118 percent suggesting that administrative costs for smaller firms may have become relatively more expensive over the period. While this was a period of significant inflation, prices as measured by the Consumer Price Index only rose by 52.7 percent between 1978 and 1983.

The Pope study looked at a different group of employer provided pension plans, state and local plans, and also concluded that significant economies of scale were found with increasing plan size. They also studied pension systems ranging from 1,000 to 650,000 employees, however, which is out of the small plan range. They found that for 1980 average administrative costs for a plan with 2,500 participants would range from $50 to $63 dollars per participant compared to costs of between $26 and $32 per participant for plans with 25,000 participants and between $12 and $16 dollars for plans with 300,000 participants. These figures seem roughly comparable to those found for multi-employer plans.

None of these studies have directly looked at the administrative expenses of small businesses; the 5500 annual report data does not provide accurate information on these expenses for single employer plans. Administrative expenses are reported in the National Federation of Independent Businesses' 1985 employee benefits survey. That study indicates that administrative costs generally decline with increasing sales and with increasing numbers of employees. Costs peak for firms with between $200,000 to $499,000 in sales at $485 per participant and decline to only $59 per participant for those firms with sales of over $10 million. Similarly, those with 3 to 4 employees pay $427 in administrative costs on a per participant basis while those with 50 to 99 employees only pay $76 per participant.

These costs tend to be lower than those found for multi-employer plans. Several factors may be responsible. First, small employers may not be counting internal administrative costs. Second, small employers are likely to have plans which are much simpler administratively than multi-employer plans; in particular, small employers are more likely to have defined contribution plans. Finally, multi-employer plans may be more expensive because they lack

*This material is abstracted in large part from from Emily S. Andrews, Pension Plans and Small Employers (Employee Benefit Research Institute; Washington DC, forthcoming 1988).

direct employer interest in cost control. In any case, the same type of scale economies appear with the small firm data from the NFIB study as the other studies have shown.

Using the NFIB data, the relationship between administrative costs and plan contributions can also be calculated. Administrative costs averaged 8 percent for all employers in the sample with fewer than 100 employees. Administrative costs tended to be somewhat smaller for firms with greater sales and more employees. Since some small employers may not make a plan contribution every year if they have a profit sharing plan, these figures represent the average administrative costs for only those firms who expected to contribute to their plan.

Table 1
A Survey of Administrative Costs
Per Participant

	Multi-employer Plans			State	Private
Number of participants	Mitchell & Andrews 1975	Cooper & Carlsen 1978	Cooper 1983	& Local Pope 1977	Small NFIB 1985
3-4	-	-	-	-	$427
50-99	-	-	-	-	$76
100	$138				
375	-	$78	$170	-	-
2,500				$50-63	-
12,000		$23	$56		-
20,000	$13	-	-	-	-
25,000	-	-	-	$26-32	-
300,000	-	-	-	$12-16	-

Source: Emily S. Andrews, Pension Plans and Small Employers (Employee Benefit Research Institute; Washington DC, forthcoming 1988).

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The Costs of Government Regulation for Small Employer Plans*

by

Emily S. Andrews

No aggregate data are available on the costs of compliance of specific government regulations such as the top-heavy rules. Nevertheless, it is instructive to review several studies which provide information on the opinions of small employers about the influence of government regulations on their decisions to start a pension plan; on the operation of their ongoing pension plans; and on their decisions to terminate a pension plan.

Four different studies (Opinion Research Corporation, 1986; James Bell and Associates, 1984; Justin Research Associates, 1985; and William J. Dennis, Jr., 1985) have asked small employers why they provide pensions, why they do not and why they have stopped providing pensions to their employees.

The Opinion Research study (1986) was conducted for EBRI and the American Association for Retired Persons and used focus groups which were conducted in each of three cities with small employers who sponsored plans and those who did not. The James Bell and Associates study (March 1984) was conducted for the Small Business Administration (SBA) in conjunction with ICF Incorporated and interviewed 18 employers about the reasons they did or did not have pension and health plans. The Justin Research Associates study (May 1985) was conducted for the SBA and interviewed 31 firms. The Dennis survey (1985) was conducted for the NFIB and was based on responses from 1,450 of their membership.

Pension Legislation and Plan Formation. All four studies speak to the effect of pension regulation on plan formation. The Bell study reported that interviewees were split about whether government regulation or paperwork involved in setting up a plan affected their decision not to offer pension benefits. Four out of seven interviewees pointed to the complexity of the laws and the paperwork involved in administration. The Justin Associates study reports that "many of the small businesses in our survey (apparently correctly) believe that the regulations are so complex that the time and money required to comply are greater than the benefits available from a pension plan." (p. 2) Firms also mentioned the uncertainty of regulations and the paperwork burdensome.

The Dennis survey provided small employers the opportunity to designate the most important reason that they did not provide a retirement plan. The effect of federal regulation could was directly asked for in the category "changing and complex regulations." Two other categories could reflect federal regulation as well: either "too much cost, red tape, and hassle to start one;" or "administrative costs to keep one are prohibitive." Only 1 percent of these employers directly cited "changing and complex regulations" as the most important reason for not providing a plan. However, another 9 percent said that start-up costs and red tape prevented them from establishing a plan. In sum, other reasons besides government regulation seemed to be the most important ones preventing plan formation. Nonetheless, many firms did not respond to the question and others may have felt that government regulations provided a secondary reason for not having a plan.

The Opinion Research study provided additional insights about federal regulations and plan formation. Nonproviders appeared to believe that retirement plans involved a great deal of paperwork and knowledge of complex regulation. By contrast, many providers felt that plan administration was not burdensome. The exceptions were those who sponsored defined benefit plans. Most interesting, perhaps, was the considerable lack of any information about the federal regulation of pensions among employers who were not plan providers.

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*This material is abstracted in large part from from Emily S. Andrews, Pension Plans and Small Employers (Employee Benefit Research Institute; Washington DC, forthcoming 1988).

Plan Administration and Plan Termination. The Dennis study found government regulation was the most important problem in maintaining a retirement plan is the impact of constant government changes. On average, 37 percent of those asked the question cite this reason (and 32 percent of the those asked did not answer the question). Dissatisfaction with changes in government laws and regulations is an even more prominent problem among those who are generally satisfied with their plans accounting for over half of all responses. Other government regulations are also cited as problems. On the whole, 7 percent of employers with plans expressed dissatisfaction over the top-heavy restrictions and another 2 percent expressed dissatisfaction over multi-employer withdrawal liability. Another 2 percent found that restrictions on fund use was a problem. In total, 48 percent of small employer problems stemmed from government regulations another 21 percent stemmed from administrative costs and other problems with 32 percent of employers asked not expressing an opinion.

This is consistent with the Dennis finding that government regulation was the single most important reason mentioned for plan termination. In fact, according to the Dennis study, 35 percent of the 10 percent of the sample who said they dropped their retirement plan said they did so because of changing and complex regulations.

What Are Small Employers Saying? The four studies reviewed present somewhat inconsistent views on the importance of government regulation. Justin Associates say that regulation is an important factor discouraging plan formation. The Opinion Research study confirms those findings. The Bell study says that the findings are mixed, however, and Dennis indicates that government requirements are relatively unimportant in influencing the decision of whether to provide a plan.

Feelings about government regulation among plan providers also seems to differ between the studies. In the Opinion Research focus groups, the plan providers found the complexity of government regulation less troublesome than those who did not have plans would have thought (perhaps because the latter did not know much about the regulatory complexities.). In contrast, Dennis found concerns about government requirements paramount to plan providers whether or not they were satisfied with their plan. Furthermore, he found that government regulation was the most important reason that firms terminated their pension plans.

Why do these studies differ? First, the methodology and scientific quality of the studies vary. For instance, focus groups are not scientifically sampled and the presence of other employers could affect the employers' responses. The Bell and the Justin surveys are based on very small samples and are thus cannot produce scientifically reliable results. While the Bell study interviewed some experts, they may not reflect the knowledge of the small-employer community. The Dennis survey is the largest but the survey format may have influenced some of the responses since the questionnaire had particular categories to select.

Second, the way the questions were asked may influence the results. While costs may be the most important reason for not setting up a plan, small employers may also feel that government regulations increase the complexity and expertise needed of manage a plan and hence increase the costs of plan formation. Similarly, while plans may not be difficult to administer for the company if they hire outside consultants to manage the plan, they may not be pleased with the need to change plan documents even though their own staff does not have to do it. In all, self responses of small business owners are only partly helpful in presenting a picture of the effects of government regulation on the presence of an employer-sponsored pension plan.

The responses to these studies are instructive with respect to the degree to which government regulation affects the decisions of small employers. Government regulation is part of the decision making process but other factors are involved as well. Economic theory suggests that regulatory concerns often may be interpreted to be concerns about the costs of regulation. Unfortunately these concerns have not been put into dollar terms by the employers.

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Senator HEINZ. Let me shift and say there are a variety of actions we could take to encourage the growth in small plans, such as simplified regulations or tax credits or deductions. Which of those do you see as having the greatest potential?

Mr. SWAIN. Well, Mr. Chairman and Mr. Heinz, I think they are all beneficial. Certainly, any time you talk about tax credits, as this committee knows better than any place else, there are revenue implications.

The relief from existing regulations does not have revenue implications—at least it doesn't have substantial revenue implications. So I think that that immediately would be helpful, not only to relieve regulations in reality but as a sign. I think that you and Chairman Pryor have heard through your careers many small business witnesses come up here on a variety of issues, and I would suspect that most of the time they are complaining about something that this committee or this Congress is proposing to do. This is almost a unique proposal. The witnesses are not complaining; they are saying, "My gosh, you are going in the right direction." And so I think a deregulation of the pension system, where these regulations, I think, are unnecessary, would be a very important positive signal.

Senator HEINZ. In the abstract, would that be more important than any deduction or tax credit we might provide to help offset either the compliance cost or a portion of the administrative cost?

Mr. SWAIN. Personally, Senator, I think it would be as important. You know, it is a matter that people——

Senator HEINZ. It would be no less important than anything else?

Mr. SWAIN. I think so. That is my opinion, yes.

Senator HEINZ. In the experience of any of you and in your interaction with small business owners, have you found examples of plans terminated primarily on the basis of administrative costs and complexities?

Mr. SWAIN. Well, Ms. Calimafde is a practitioner.

Ms. CALIMAFDE. Yes. Unfortunately, we have found a lot of examples of that. The reason most often given is—and I will give it to you the way it is said to me--"I want to get out of this. I am tired of this, and I am not going to pay you or anyone else another dollar to get this plan in compliance with something I don't understand anymore."

Senator HEINZ. Can you provide the committee with information on those kinds of terminations and how many you have had, and any other additional information on them?

Ms. CALIMAFDE. Yes, I will try to do that.

[The information follows:]

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United States Senate
COMMITTEE ON FINANCE
WASHINGTON, DC 20510

October 30, 1987

Paula Calimafde
Paley, Rothman & Cooper
4800 Hampden Lane
7th Floor
Bethesda, MD 20814

Dear Ms. Calimafde:

Thank you for the excellent testimony you provided to the Senate Subcommittee on Private Retirement Plans on the "Small Business Retirement and Benefit Extension Act of 1987" on October 23. The expertise you brought will help guide us as we consider this very important piece of legislation.

As I mentioned at the hearing, I would appreciate if you could provide the Subcommittee with any information you may have concerning small employer pension plans which terminate due to high administrative costs. Any information specific to costs associated with the "top-heavy" rules would be particularly helpful.

If you have any questions, please contact Laura Erbs of my staff at (202)224-1467. Your prompt attention to this matter will help to complete what I believe was a very good hearing record.

Sincerely,

John Heinz

JOHN HEINZ
United States Senator

JH/lae

c.c.: The Honorable David Pryor

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†D.C. BAR ONLY

February 29, 1988

The Honorable John Heinz
United States Senate
Committee on Finance
Washington, DC 20510

Dear Senator Heinz:

On behalf of the Small Business Council of America and the Small Business Legislative Council, I want to sincerely thank you and Senator Pryor for giving us the opportunity to discuss the problems encountered when a qualified retirement plan is sponsored by a small business. As mentioned in my testimony, most of these problems seem to be the result of frequent, major changes in the law combined with complex and often picayune regulation. The frustration expressed on this issue by small business owners at the White House Conference on Small Business in 1986 was clear. This was embodied in the 20th recommendation from the Conference, a copy of which is attached. If one could fairly summarize the major complaint expressed, I believe it would be somewhat similar to the following: Congress and IRS either do not understand the practical effect of all these changes and technical rules on a retirement plan sponsored by a small business and the costs that must be absorbed by the business because of them or they do not care that they are effectively dismantling the small business retirement plan system. By holding these hearings, we now know that there are at least some lawmakers who want to hear the problems and who are committed to promoting the system by simplification rather than doing it in.

Attached to this letter is the information which you requested during the hearing. This was the best I could do within the parameters of my available time and resources. I hope it is of some use to the Committee. It appears that your question as to the "costs" associated with the various technical requirements, such as the top-heavy rules might well be the and effort on this significant area of concern for small business owners.

Sincerely,

Paula A. Calimafde

cc: The Honorable David Pryor

Additional Information Requested
by The Honorable John Heinz
to supplement the record of the hearings on
the "Small Business Retirement and
Benefit Extension Act of 1987"
before the
Committee on Finance
Subcommittee on Private Retirement Plans and
Oversight of the Internal Revenue Service

Pursuant to The Honorable John Heinz's request to provide additional information with regard to small employer pension plans which have terminated due to high administrative costs, the following is respectfully submitted by Paula A. Calimafde on behalf of the Small Business Council of America, Inc. and the Small Business Legislative Council.

A random sampling of small business retirement plan specialists who represent in some capacity or another over 1800 qualified retirement plans sponsored by small businesses was conducted. The data from this rough sampling showed that on the average twenty percent (20%) of all small business plans were terminated during the last two years. This percentage varied somewhat depending upon location of the plan. The amount of terminations was significantly higher than other years subsequent to the passage of ERISA (Employee Retirement Income Security Act of 1974).

The overwhelming reasons given for termination were: costs due to complex rules, the impact of TEFRA (Tax Equity and Fiscal Responsibility Act of 1982), the burden of complying with the top-heavy rules and the impact of the TRA (Tax Reform Act of 1986). In short, administrative burdens and costs and/or decreased benefits available to the owners and key employees of the business were the most commonly cited reasons for termination of plans.

Here are some specifics. The most complete study was undertaken by the American Trust Company of Hawaii, Inc. This company serves as custodian trustee for qualified retirement plans without investment management responsibility. The Trust

Company tracked new defined benefit and new defined contribution accounts from 1981 to 1987.

Over that seven year period, the Company served as trustee for 1,118 new qualified retirement plans - of these 453 were new defined benefit plans and 665 were new defined contribution plans. In 1981 and 1982, before the passage of TEFRA, new defined benefit plans outnumbered defined contribution plans. Beginning with 1983, the reverse began to hold true. The attached chart, labeled Exhibit A, reflects this trend with the straight line representing new defined benefit plans and the dotted line representing new defined contribution plans.

Over the same years, 550 plans were terminated, almost equally between defined benefit and defined contribution plans. Terminated plans have grown to be just under 50% of the 1,118 new qualified retirement plans the Trust Company accepted during the same period. The principal reason stated by clients for terminating 181, or 65 percent, of the 268 defined benefit plans was TEFRA-related. These included the cost of compliance, over-funding of the plan as benefit limits were reduced, and the necessity of compliance with the stringent top-heavy requirements. Other reasons given for termination included the deluge of detailed Congressional legislation and regulations which have run up the cost of administering these plans.

The charts labeled Exhibit A shows some alarming trends. For instance in 1981, there were 229 new plans utilizing the Trust Company 's services as trustee. Fourteen plans represented by the Trust Company terminated during that year. This represents about seven percent (7%). In 1987, 133 new plans started up with the Company and 131 plans terminated. This represents about a 98% termination rate as compared to start-ups.

The Trust Company represents a cross section of small business in Hawaii. In Hawaii, according to the President of this Company, there are only 500 companies with more than 100 employees. (Many of these large companies are branches of mainland or foreign organizations.) The study concludes that

because of TEFRA, 2,625 employees in Hawaii small businesses are no longer covered by a retirement plan.

My office presently represents approximately 500 defined contribution plans and 100 defined benefit plans. These plans are primarily sponsored by small and mid-size businesses. We do not serve as trustees of the plans nor give investment advice. Prior to TEFRA, many of our small business clients were adopting defined benefit plans. New defined benefit plans are now running close to zero (this is in part due to our advice - a defined benefit plan under the current retirement plan laws appears to be in many circumstances an albatross for a small company). Last year defined benefit plan terminations (or a freeze of benefit accruals under the plan) ran roughly 18% of all defined benefit plans we represented. Our guess is that this year we will see a similar percentage of terminations or freezes. This is due in part to the impact of the 1987 Revenue Act which again imposes additional burdens on companies which sponsor a defined benefit plan. It also appears to be partly due to the cumulative effect of the constant changes and amendments imposed by law combined with the decrease in benefits for the key employees of a small business.

Interestingly, the same trend does not seem to be reflected in the defined contribution plan area. Terminations appear to be occurring randomly and are probably running less than 5%. Most appear to be the result of adverse business conditions or the company going out of business. Many of the companies which sponsor these plans have told us that they are dismayed and concerned at the costs associated with the ongoing operation of the plan because of Congressional and IRS regulatory changes. At this time, however, it does not appear that these companies have actually chosen to terminate the plans. What the impact of the lower personal income tax rates will be on this situation is too hard to judge at this time.

The impact of the top-heavy rules on many of the defined contribution plans which my firm represents was negligible. This

is because the vast majority of the small business plans already contributed well in excess of the required minimum contributions and most had vesting schedules which met the requirements of the top-heavy rules. The major cost of the top-heavy rules for these plans was adding the bulky and technical amendments required by the top-heavy rules. The plans which were hit the hardest by the top-heavy rules are those which we refer to as "marginally top-heavy". These are plans which are generally sponsored by the larger small business or by a mid-size business. The plans were designed to operate only if they are not top-heavy. If such a plan were to become top-heavy, the company would have to absorb unacceptable increases in costs, primarily due to the acceleration of the vesting schedule and required minimum benefits. Thus, to ensure the plans do not accidentally swing into top-heavy status, these companies have the top-heavy status determined each year by a pension administration firm under exceedingly complicated rules at a significant cost. These plans are trapped between the world of big plans (which because of the pyramidal structure of the company are never top-heavy) and small plans (which because the ratio of key employees to staff employees is so lean are almost always top-heavy).

A pension administration firm in the Washington, D.C. area which represents primarily defined benefit plans sponsored by small and mid-size businesses reports the following statistic. Of the 500 defined benefit plans represented by this company last year, approximately 100 of the plans terminated or froze benefit accruals. This firm is anticipating another 20% termination rate for this year.

Patricia L. Brown, a lawyer from Las Vegas, Nevada, reports that administrative costs (as reported to her from all of the administrative firms who were willing to discuss actual numbers) have increased from an average of $350.00 per year to $1,200.00 per year. This increase has taken place over the last two years. Legal fees on these plans, in addition to the pension

administration fees, ran approximately $1,000.00 per plan per year. She believes that these costs have in many cases made the difference between a company continuing its plan or closing it down.

In the past two years, she has terminated five VEBA's, 46 defined contribution plans, and 26 defined benefit plans. She is in the process of terminating another 14 qualified retirement plans at this time. The impact of these terminations is that over 5000 employees have lost retirement plan coverage.

This represents the conclusions from a very rough survey. The SBCA and the SBLC hopes this information is of some use to the Committee.

EXHIBIT A

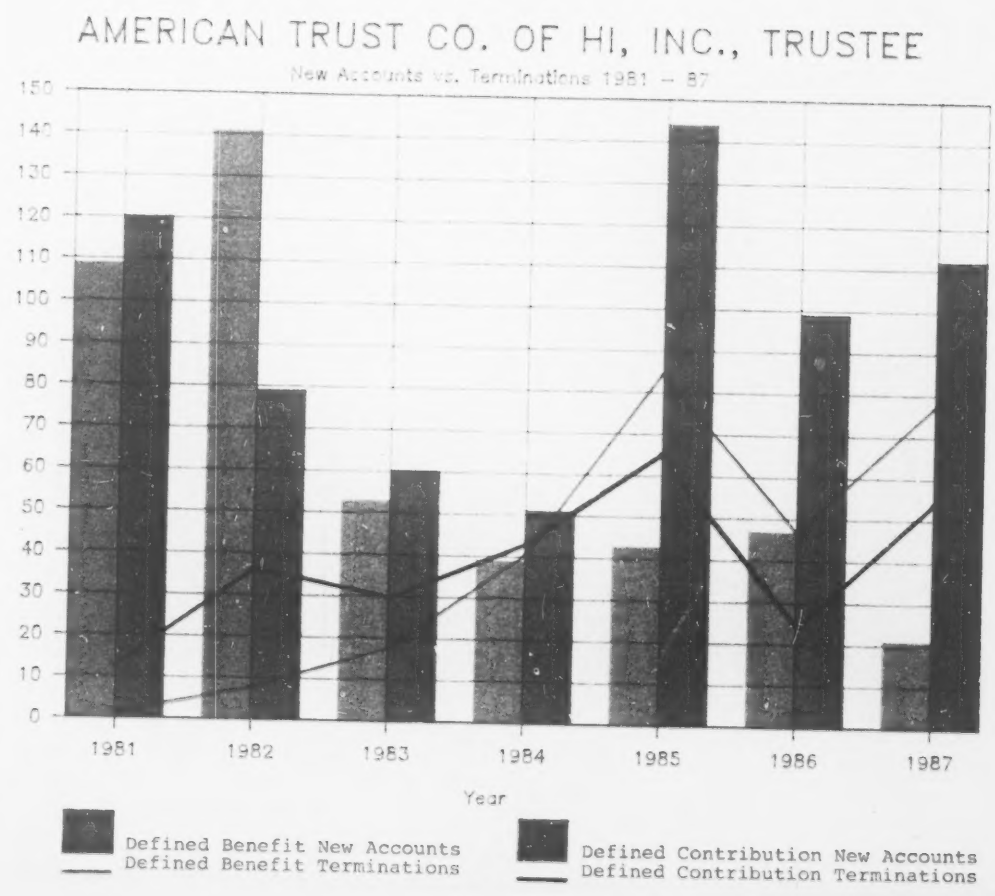
AMERICAN TRUST CO. OF HI, INC., TRUSTEE
New Accounts vs. Terminations 1981 - 87
150
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
1981
1982
1983
1984
1985
1986
1987
Year
Defined Benefit New Accounts
Defined Benefit Terminations
Defined Contribution New Accounts
Defined Contribution Terminations

EXHIBIT A

[illegible] OF NEW ACCOUNTS AND TERMINATED ACCOUNTS 1981 - 1987

	1981				1982				1983				1984				1985				1986				1987			
	NEW ACCOUNT		TERMINATION		NEW ACCOUNT		TERMINATION		NEW ACCOUNT		TERMINATION		NEW ACCOUNT		TERMINATION		NEW ACCOUNT		TERMINATION		NEW ACCOUNT		TERMINATION		NEW ACCOUNT		TERMINATION	
Month	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.	DB	Dr.
JANUARY	10	13	1	1	20	21	1	1	41	51	1	1	51	21	1	1	31	81	1	1	21	111	1	1	11	51	1	1
FEBRUARY	61	51	1	1	81	61	1	1	21	41	1	1	41	31	1	1	41	111	1	1	71	51	1	1	11	61	1	1
MARCH	121	171	1	1	81	21	1	1	91	81	1	1	31	41	1	1	01	51	1	1	151	131	1	1	61	141	1	1
1ST QTR TOTAL	28	31	0	5	36	19	0	10	15	17	7	9	12	9	3	7	8	23	10	10	36	29	11	11	8	26	2	11
APRIL	3	21	1	1	14	51	1	1	31	51	1	1	21	61	1	1	11	71	1	1	11	81	1	1	01	61	1	1
MAY	41	51	1	1	11	61	1	1	41	21	1	1	51	41	1	1	31	171	1	1	31	61	1	1	01	21	1	1
JUNE	41	11	1	1	15	10	1	1	51	51	1	1	31	51	1	1	31	251	1	1	21	71	1	1	31	51	1	1
SECOND QTR TOTAL	91	71	0	3	40	21	3	7	121	121	3	6	111	151	13	8	111	491	13	12	71	211	11	5	31	151	4	21
JULY	81	171	1	1	171	91	1	1	31	41	1	1	81	51	1	1	61	131	1	1	11	31	1	1	11	81	1	1
AUGUST	151	81	1	1	91	31	1	1	11	31	1	1	21	31	1	1	61	91	1	1	31	31	1	1	21	111	1	1
SEPTEMBER	131	141	1	1	71	111	1	1	31	51	1	1	11	21	1	1	51	91	1	1	21	61	1	1	11	81	1	1
THIRD QTR TOTAL	36	111	0	3	33	13	3	11	71	10	4	6	111	81	12	7	171	371	25	12	61	201	10	7	61	311	16	8
OCTOBER	101	61	1	1	61	41	1	1	51	31	1	1	41	111	1	1	11	41	1	1	21	51	1	1	21	111	1	1
NOVEMBER	121	31	1	1	101	61	1	1	61	51	1	1	91	21	1	1	31	51	1	1	31	71	1	1	31	111	1	1
DECEMBER	141	191	1	1	161	151	1	1	81	131	1	1	71	61	1	1	111	251	1	1	51	151	1	1	31	251	1	1
FOURTH QTR TOTAL	361	281	11	21	321	251	41	91	191	271	41	91	51	191	121	201	51	141	221	221	81	371	131	81	41	151	61	141
CURRENT CALEND TOTAL	1291	1271	41	131	1411	71	81	371	531	661	181	301	351	511	401	421	431	1441	881	561	471	1131	411	261	211	1121	771	541

EXHIBIT A

AMERICAN TRUST CO. OF HAWAII, INC.
REASONS STATED FOR TERMINATION OF DEFINED BENEFIT PLANS 1981-87

Page 1

TERMINATION REASONS	1981	1982	1983	1984	1985	1986	1987
ADVERSE BUSINESS CONDITIONS			1	7	5		1
DISSOLUTION OF BUSINESS/SALE/ OWNERSHIP CHANGE			2	4	5		4
CLIENT DECIDED AGAINST TRUST/ CANCELLED PLAN	1	7	6	3	5		4
PRINCIPAL RETIRED/ DISABLED/DIED		1	2	4	2	1	2
TEFRA RELATED REASONS			2	18	62	40	59
PERSONAL REASONS			1				
BANKRUPTCY				1			
ATCO RESIGNED							1
OTHER			2	2	5	5	6
TOTAL:	1		16	40	84	47	77

Senator HEINZ. Now, to what extent have these kinds of factors, in your judgment and experience, kept small businesses out of the pension arena?

Mr. SWAIN. I think the regulatory factors have been quite significant. They are not responsible for the entire situation. Most small firms that do not have pension plans probably do not have them because they do not feel they have the adequate profits to establish them. But the fact is, when they set aside an amount of money that is available to establish a pension plan, the more of that money that has to go to administrative costs versus going into the plan to actually help employees, I think the more skewed that ratio is, the less likely they are to establish plans in the first place.

So I would hazard a guess that a significant percentage, not certainly the majority but a significant number of the small employers that do not have pension plans, do not do so because of what they feel is the regulatory morass that they have to step into.

Senator HEINZ. If that is true and we were to repeal the top-heavy rules, we should see an increase in new plan start-ups. Would we?

Mr. SWAIN. This reminds me of the old saying, "If you are so smart, why ain't you rich?" I think you should see some increase in new plan start-ups. I wouldn't want to hazard a number.

Senator HEINZ. You seem to be a little more hesitant about that. Why? You may have good reason for being hesitant, and it would help if you would fill in why. After having said that it is a significant factor and then, faced with the reality of the world, which is always more difficult to predict, as we found out on Monday, why do you become hesitant?

Mr. SWAIN. Yes, I would be happy to explain that.

I stand by my statement that I believe regulation has a significant deterring effect. Were you to repeal or significantly reform one aspect of the regulations, in this case the top-heavy rules, I think that would have some effect. But I don't know how much that effect would be in comparison with the existing rules that are also in place under DEFRA, TEFRA, REA, and the Tax Reform Act of 1986.

So, I think we can't change the whole system. Nobody has an interest in going back to a pre-ERISA situation, but we have a system that is not functioning, and it seems to me that there is a modest reform that Senator Pryor has proposed and that you have spoken substantively on in the past yourself that I think will have a beneficial effect without having any problems as far as coverage is concerned.

Senator HEINZ. Ms. Calimafde, what do you think? If all we did was to repeal the top-heavy rules, would you suspect there would be much, or not too much, in the way of new plan start-ups as a result?

Ms. CALIMAFDE. I would suspect there would be a slight increase. As I mentioned earlier, it is not just the top-heavy rules that are the problem. That is a major problem, but that is not the only problem, and I will just run through a very few examples:

In the last several months, in the single area of plan distributions, IRS has issued more than 200 pages of regulations. And the statute alone on distributions—and this doesn't even include some

of the subsidiary distribution issues—runs more than 20 pages. That is the statute.

That is the problem. And you have got to get back to a system where the rules are based on rationality and they are simple, and then they stay in one place for a long time, because a pension plan is a long-term commitment.

Senator HEINZ. Just to clarify one thing: While the repeal of the top-heavy rules wouldn't necessarily create a tidal wave of new plan participation and start-ups, my impression from what you said is that the repeal of the top-heavy rules might decelerate the number of small business terminations. Is that a fair interpretation of what you have said?

Ms. CALIMAFDE. Yes, I think that is true.

Senator HEINZ. We won't gain much on the upside but we can keep terminations from continuing at the rate at which they are likely to do so?

Ms. CALIMAFDE. And I think that is primarily because it is a signal to the small business community that the voluntary private system is going to be encouraged, because many small business owners think that it is just being actively discouraged right now.

Senator HEINZ. Mr. Chairman, thank you very much. You have been most generous.

Senator PRYOR. Thank you, Senator.

As one final question: If I were a small business person with 100 employees and wanted to set up a plan, how long would it take to get that plan approved by the Service? Or "accepted" I guess would be the best word.

Ms. CALIMAFDE. Right now, they are running about 270 days from the time you submit the plan.

Senator PRYOR. Is that a longer period of time than has been traditional? I mean, is it taking longer and longer?

Ms. CALIMAFDE. Much longer, but IRS is contending with the same things we all are, which is that this statute is almost incomprehensible right now. So, they are in a very difficult situation. It is not that anyone at IRS is not trying to do their job; it is just that the job is almost impossible today. But to answer your question the time it takes to get a plan approved is much longer.

You know, there are just constant ongoing regulations, and as they become final, then IRS has to put those regulations into the plan and make sure that is covered. So it is the ongoing, changing process that they are trying to keep up with right now.

Senator PRYOR. Well, you have been a splendid panel. Very fine testimony has been given this morning by this panel, Senator Heinz.

We are indebted to you, and, once again, your full statements will be put in the record. I believe that Senator Heinz may have some questions he may have wanted to submit in writing.

Is that correct, Senator Heinz?

Senator HEINZ. I may.

Senator PRYOR. Fine.

We appreciate your coming in, as we call our second panel. Thank you.

We have four distinguished panelists here to come before the committee this morning. First, Mr. Abraham Schneier; and I be-

lieve you are with the National Federation of Independent Businesses. We appreciate your being here.

We have Ms. Louise Crooks, who is president-elect of the American Association of Retired Persons, AARP. We welcome you.

Mr. Frank Mason, president of the Mason Corporation, and chairman of U.S. Chamber of Commerce, Labor and Employee Benefits Committee. We appreciate your attendance.

And Mr. Gary Kushner, the president of Kushner and Company, testifying on behalf of the National Small Business United. We appreciate your being with us.

Once again, we will abide by the 5-minute rule on our opening statements, and any opening statement that is not orally presented will be placed at the appropriate place in the record.

So, we will call on Mr. Schneier.

STATEMENT OF ABRAHAM SCHNEIER, LEGISLATIVE REPRESENTATIVE—TAX, NATIONAL FEDERATION OF INDEPENDENT BUSINESSES, WASHINGTON, DC

Mr. SCHNEIER. Thank you, Senator Pryor.

On behalf of the National Federation of Independent Businesses, 500,000 members, I would like to thank you for giving us the opportunity to testify on your legislation, S. 1426, the Small Business Retirement and Pension Extension Act. And while I would like to submit my statement for the record, since reference has been made to our study on employee benefits, I also have this, and I would be happy to submit that for the record as well.

Senator PRYOR. Yes.

Mr. SCHNEIER. I think, as we have already heard, the concern about pensions is coming from several directions. At the same time that there is tremendous pressure on the small business community to increase the number of employees who are covered under some type of pension coverage, there have been substantial increases in costs due to changes in regulations, changes in the laws, as well as changes in the ways in which pension plans have to just simply be structured.

Since 1982 we have seen several pieces of legislation which have dealt with this issue, and the concerns have been twofold: (1) they have been revenue concerns, driven in part by the need to find revenues as part of our deficit-reduction need since 1982; and (2) the real concerns that there were abuses in several areas. As someone has commented, though, perhaps we have gone a little bit too far with some of the concerns over the abuses or some of the remedies toward the abuses.

I think NFIB's membership clearly is concerned that, when you impose such substantial costs on the ability of the small business to implement the plan or maintain a plan, the number of plans will simply drop. And our survey on employee benefits surely bears that out. When we asked our members who had not established a plan why they had not established a plan, 39 percent said that they could not afford the plan; and that percentage increases dramatically if you break it down by size of firm or by number of employees per firm. In fact, with less than four employees per firm, it was somewhere around 50 percent in that same category, then the ad-

ministrative costs and the start-up costs also became an additional factor—nine percent responded that that was their major concern.

It is clear that pension policy has to somehow—and I don't want to repeat what has been said about the concerns about top-heavy; I think those points were well made, and I wouldn't want to repeat that. But clearly, the pension policy people need to sort of determine where we want to go with all of this, and we have had this continuous barrage of legislation in this area with no clear goal, it would appear.

If we really want to expand the pension coverage for small employers, we are certainly not going about it in the best way possible, which is why your proposal for repealing the top-heavy rules as well as providing some kind of an administrative cost benefit for the small employer to begin a plan and maintain a plan is something which we feel is very appropriate.

The small business owners have often been characterized—I think unfairly—in the same category as the professional corporation situation, which I think drove a lot of the abuse concerns earlier on. And we certainly have seen that our members want to start employee benefit plans, want to provide pension coverage, health insurance coverage, whatever it might be, because it makes good business sense, because it is good for their employees and if it is good for their employees, it is good for their business.

I would be happy to respond to any specific questions, especially related to our benefits survey, and I think the issues of cost and of continuous regulation is something which needs to be addressed by this committee.

We would certainly be happy to see the committee—the subcommittee as well as the full committee—take a more broad examination. As in the 1986 Tax Reform Act, the massive changes which were made by the committee were done based on one day of hearings. That always gave us some cause for concern.

Again, I think we need to sit down and determine where the situation is currently in pensions, where we want to go with pensions, and what is our ultimate goal. And I think the small business community is very willing to sit down and openly discuss where the best interests of the small business community would be in the nation as far as our employers and employees.

Senator PRYOR. Thank you very much, Mr. Schneier. I may have a couple of questions, and I think Senator Heinz will return shortly.

[Mr. Schneier's prepared statement follows:]

STATEMENT OF

ABRAHAM SCHNEIER

LEGISLATIVE REPRESENTATIVE

NFIB

Mr. Chairman, on behalf of the over 500,000 members of NFIB, I would like to thank you for holding these hearings on S.1426, the Small Business Retirement and Benefit Extension Act. On behalf of NFIB, I wish to once again congratulate you for introducing this proposal. NFIB believes that a review of pension policy as it applies to small business is long overdue. We hope that this hearing will begin the process of fashioning a pension policy which will provide small business owners and their employees some long-range security.

The Policy Dilemma

Just two weeks ago the American Law Institute held a conference to examine ERISA (The Employment Retirement Income and Security Act of 1974). Some of the points raised are illuminating:

47% of all employees in the private sector are participating in a private pension plan.

32% of employees in firms of fewer than 100 employees are participating in a pension plan.

Projected tax expenditure for pensions for 1988 is $57.8 billion.

The general population is placing greater reliance on social security to provide retirement benefits and medical coverage at retirement. Policy planners realize that not everyone can be accommodated and at some point, these programs are going to have to draw lines beyond which benefits will be limited--another way of saying means testing. Yet means testing cannot succeed unless individuals have other forms of retirement savings and health

insurance coverage. Private savings and employer-sponsored plans will be used to make up the difference in the form of private health and retirement benefits.

Small employers clearly must be concerned that several problems have converged to make pensions unattractive to small employers:

1. Current pension law places total responsibility on the employer for the pension plan, with no employee involvement.
2. Constant changes in pension rules requiring annual plan amendments and annual plan filings of a series of complex forms, which must be filed with three federal agencies, impose substantial costs which must be absorbed by the employer.
3. Many small employers are unable to commit to long-term pension plans due to unstable profit predictions and the fear that any commitment might not be met in some years.
4. No credit is given to the employer for already providing some pension coverage through social security. Congress places severe limitations on integrating pension benefits with social security benefits.

In part these concerns have converged to create a substantial cost barrier for small firms starting and maintaining pension benefits for employees. NFIB supports S.1426 because it recognizes the concerns of the small business owner and we believe may return some of the incentive for establishing a pension or profit sharing plan.

Background

The enactment of ERISA brought about a new age in pension policy. Three government agencies were empowered to police employers' pension plans and to verify that promised benefits were being delivered and that plan assets were being adequately protected from losses.

A large part of the support for passage of ERISA came from the business community. Businesses wanted rules for protecting pension plans and in return were promised incentives to establish and maintain pension coverage for employees. The tradeoff between

expanding pension benefit coverage and providing incentives to employers to provide additional fringe benefits was uniformly supported. Now the debate in pension/policy has turned around: pensions are no longer viewed as a fringe benefit but as a minimum working standard.

In 1982, during the first major congressional effort to reduce the deficit through tax increases,the first serious efforts were made to limit pension plan benefits to business owners and to require greater participation by employees. Passage of the top heavy rules, as a part of the Tax Equity and Fiscal Responsibility Act (TEFRA), heralded a new period in pension policy. Congress sought to ensure that the great majority of benefits in a firm were not simply going to the owner and a few key employees.

At the same time maximum benefit levels were reduced and maximum contribution levels were reduced to prevent any abuses. This was accomplished in the name of tax equity with no consideration of the effect that these rules would have on employers who were looking at the needs of their workers and considering establishing plans.

Since TEFRA we have seen repeat performances in the 1984 deficit reduction bill and most recently the massive changes made in the Tax Reform Act (TRA) of 1986. The combination of these three bills along with the Retirement Equity Act have resulted in massive confusion among small business owners and their advisors as to how to plan for the future. Small employers who were considering establishing plans have held off, and many small employers who have plans are seriously considering cancelling their plans and going to straight profit sharing arrangements.

Top Heavy Rules

Top heavy rules are designed to prevent an employer from promising worker benefits which are never delivered by imposing a

shortened vesting period and increased participation benefits. Before the rules were enacted, some firms had vesting plans which would result in full vesting in as many as fifteen years. The top heavy rules enacted in TEFRA changed this picture by requiring an employer to vest his employees in three years if more than 60% of the plan benefits, whether as a result of design or as a result of circumstances, were being directed at the owner and his key employees.

It is commonly known that the average small business owner has fewer than 25 employees and that the typical small business has a highly transient workforce. The American workforce at large has become highly transient, and predictions are that the typical worker may have as many as eight different careers in his working life. The top heavy rules exploit this transient nature of the workforce by forcing employers to provide the same benefits to an employee who has been with a firm three years as to the long-term employee.

The Tax Reform Act exploited to a greater degree than before the confusion and lack of understanding by many of what is involved in the pension issue. The vacuum was filled by a legislative proposal which imposed new definitions of participation, new standards for vesting, and new definitions of highly compensated and key employees.

The problem now is that Congress has put in place legislative rules which compete with each other and make top heavy and qualification determinations more difficult than ever before.

For example, the top heavy rules enacted in TEFRA hinge on a definition of "key employees". The determination of who is a key employee affects the determination of whether the plan is top heavy. In the TRA, Congress adopted a new standard called "highly compensated" for determining adequate participation rates. Under the TRA, all plans, top heavy or not, must comply with the new

provisions. Where tax reform rules are identical to or more comprehensive than the top heavy rules, the top heavy rules have no impact on retirement benefits or plan design. Where the top heavy rules differ from the TRA provisions, the top heavy rules and TRA rules exist side by side.

Comparison of "Key Employee" vs.
"Highly Compensated Employee"

	"Key Employee" Under TEFRA	"Highly Compensated Employee" Under TRA
5% owner	yes	yes
1% owner earning over $150,000	yes	yes
One of 10 employees with largest percent of ownership earning over $30,000	yes	possibly
Officer with salary over $45,000	yes	yes
Earnings over $75,000	no	yes
Earnings over $50,000 plus one of top 20% earners in company	no	yes

As illustrated, the two definitions vary, adding complexity and expense for a small employer trying to comply with pension policy.

NFIB strongly supports the proposal to repeal the top heavy rules which exist in the current law. Top heavy rules are unnecessary. The TRA has established controls far tighter than ever existed under ERISA for ensuring employee benefits are being conveyed.

Credit for Administrative Costs of Maintaining a Qualified Plan

As successive Congresses sought to raise revenues by limiting pension plans, the rules have required annual expenditures of $2,000 and up for amending plan documents and filing such amendments with the responsible agencies. These increased costs have come at the same time that annual qualification rules require ever greater expenditures on analysis by a pension consultant to determine continued plan qualification.

The annual overhead costs for maintaining a pension plan and for taking care of the administrative burdens have been steadily increasing. The cost barrier for a small employer considering beginning a plan has therefore increased quite dramatically, and even the most aggressive pension consultant cannot determine what future costs might be because what may be enacted by future Congress is so uncertain.

If Congress is serious about expanding voluntary pension coverage, some manner of reimbursement for administrative and maintenance costs must be considered. As Congress continues to place excessive administrative costs on the employer, the employer should be partially reimbursed for the increases.

In 1985, NFIB surveyed its members on concerns with pension and profit sharing plans and reasons why NFIB members were not providing pension coverage. As the following table reveals, 39% cited affordability, and 9% cited start up costs as the key reasons for not starting a plan.

SMALL BUSINESS OWNER REASONS EMPLOYEE RETIREMENT PLAN NOT PROVIDED ALL FULL-TIME EMPLOYEES BY FIRM SIZE
(in percent)

	FIRM SIZE (FULL-TIME EMPLOYEES)							
REASON NOT PROVIDED	1-4	5-9	10-19	20-49	50-99	100+	No Answer	Total
Can't Afford One	50	37	29	33	22	18	28	39%
Start-Up Costs, Red Tape, Etc.	8	9	13	15	7	*	3	9%
Employees Prefer Compensation	6	6	8	4	11	6	5	6%
Too Much Employee Turnover	5	3	6	1	4	*	2	4%
Administrative Costs	*	*	1	*	*	6	*	*
Capital Needed to Reinvest in the Business	5	5	7	3	7	6	5	5%
Changing and Complex Regulations	*	1	2	3	*	6	*	1%
Insufficient Owner Benefits	3	6	3	4	*	*	2	3%
No Answer	23	33	31	37	48	59	54	33%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Number of Resp.	484	252	150	100	27	17	146	1176

* less than 0.5%

Conclusion

The membership of NFIB is concerned that the constant changes in pension rules which result in reduced coverage of employees by small employers is becoming a self fulfilling prophecy, and that universal mandated pension coverage is the result. NFIB strongly supports your efforts both to simplify pension rules and to provide some reimbursement for administrative costs as positive steps toward reinvigorating the small business pension plan.

We look forward to working with you and other members of Congress to achieve some rationality in pension legislation for small business and to achieve increased coverage for employees of small businesses, the most important resource of our small business economy.

SMALL BUSINESS EMPLOYEE BENEFITS

by

William J. Dennis, Jr.
NFIB Research & Education Foundation

Executive Summary

* Paid vacations and health insurance were the two most common employee benefits found among the nation's small businesses. They were the only benefits provided by a majority of the small employers surveyed.

* Larger businesses tended to provide more benefits for a greater proportion of full-time employees than did smaller businesses.

* There appeared to be an accepted hierarchy of benefits or a tacit order in which benefits were introduced.

* The median monthly employer cost of voluntary employee benefits, i.e. benefits not provided by legal compulsion, was $1,450 for those providing at least one benefit. Mean or average monthly costs were twice that, pulled upward by a very few firms. The ratio of mean monthly voluntary benefit costs to annual gross receipts was inversely related to firm size. Compulsory employee benefits, i.e. legally required benefits such as FICA and Workers Compensation, cost small business owners about as much as did voluntary benefits.

* The number of small business owners providing employee health insurance has been rising. Sixty-five (65) percent offered

health insurance coverage for at least some full-time employees, an increase of eight percentage points from a similar survey conducted in 1978. Most responsible for the increase were financial service, professional service, retail, and smaller firms.

* Well over 80% of health insurance plans offered in small firms carried an option for dependent coverage. However, few part-time employees were provided any health benefits.

* The mean monthly health insurance premium paid by small employers was over $1,766, more than double the monthly premiums paid in 1978. A majority of small employers absorbed 100% of the premium with the smallest employers most frequently paying the full cost.

* Small business owners purchased private health insurance from a great variety of carriers. Self-insurance (4%) and HMO's (3%) remained an oddity.

* While the firm was the group sponsor more often than not, trade/business associations have been increasingly assuming that role. Apparently, the trend to greater association sponsorship is tied directly to increasing employee health coverage in small firms.

* Nearly 2/3's of small business owners with health insurance reported they were generally satisfied with the health care plan offered their employees. That represented a 17 percentage point drop from 1978 and can be directly related to insurance costs.

* Small business owners and/or a designated employee spent comparatively little time searching for health insurance alternatives, health care cost control options, etc. Outside advisors, particularly insurance agents, often substituted for owner/employee search.

* Employee health insurance was not provided by about one-third small employers. No single reason dominated their decisions. The most frequently cited reasons were: generally covered under a spouse or parent policy (secondary wage earners), premiums too high, employee turn-over too great, firm insufficiently profitable, and can't qualify for group policy.

* No dramatic increase in the quantity of employee health coverage should be expected in the near future. The composition of the labor force and differences in small business profitability will limit growth in the proportion of small business owners instituting employee health insurance

plans. However, coverage will continue to rise as the increase in health care costs decline, labor markets accept it as a condition of employment, and associations make it increasingly accessible for the smallest.

- Few small businesses provided employee retirement plans. Of those made available, the defined contribution type appeared most popular. But in a recurrent theme, substantial percentages of small business owner respondents were not familiar with the terminology or specifics of the plan for which they were paying.

- Outside advisors often influenced plan selection. Contribution flexibility, tax advantages, and ease and cost of start-up were major considerations in plan choice.

- The small business owner or a designated employee served as the plan administrator in a plurality of instances. Bank trust departments were the second most frequent source of plan administration.

- The most common reason for instituting a retirement plan was the need to keep valued employees, followed by the general feeling that employees needed a plan.

- Sixty-five (65) percent of business owner respondents expressed general satisfaction with their employee retirement plan. Those with defined contribution plans were most frequently satisfied. Yet, at one time or another, one in ten has either cancelled or withdrawn from a plan.

- Constant change in governmental rules and regulations was far and away considered to be the most important problem in maintaining an employee pension plan.

- The most frequently cited reason for not providing a retirement plan was affordability. However, 1/3 did not respond, probably indicating important alternatives were not provided the respondent.

- Accountants were most often the single most important source of information on retirement planning for small business owners. Insurance agents and financial consultants followed in frequency.

EMPLOYEE BENEFITS

Paid vacations, health insurance, life insurance, and paid sick leave were the most common types of benefits offered to full-time employees working in small businesses (Table 1). A variety of other

benefits, e.g., employee discounts and pension plans, were also common but provided with lesser frequency. Some benefits often found among large and medium employers, e.g., legal assistance and dependent care, were rarely present among the nation's small firms.

Two types of employee benefits--paid vacations and health insurance--were provided by a majority of small business owners. Nearly three of every five (59%) small firms offered paid vacations to all full-time employees who have completed any applicable probationary period. Another 18% provided paid vacations to some employees, meaning the benefit was available from 77% of those surveyed. Health insurance followed in frequency. Sixty-five (65) percent offered health insurance. As with paid vacations, not all full-time employees in small businesses with health insurance received the benefit. Two-thirds (42% of the total) of those with health insurance provided the benefit to all full-time employees and 1/3 (23% of the total) provided it to just some of them.

The frequency of eleven other employee benefits and their availability to full-time employees can be found on Table 1. They ranged in popularity from life insurance (49% of small businesses) to legal assistance (4% of small businesses). But with the possible exception of employee discounts, in no instance did smaller firms provide benefits to a greater proportion of full-time employees than did medium and large sized firms.

A significantly greater percentage of employees working in small businesses received benefits than was the percentage of firms providing them. The reason for this apparent anomaly was the direct relationship between employee size and benefit provision--the larger the small firm, the greater the percentage of full-time employees receiving a benefit (Table 2). For example, 80% of small businesses employing more than 100 people purchased life insurance for every full-time employee, just 21% of those employing 1-4 people provided a similar benefit. Thus, while 33% provided life insurance for all employees and another 14% provided it for some employees (48% in total), roughly 75% of all small business employees received coverage. Provision of employee discounts, related to industry not size, was a notable exception.

The mix of those providing a specified benefit for all employees as opposed to those providing the benefit for just some employees, usually ran between 2:1 and 3:1. For example, dental insurance was provided for all full-time employees in 11% of firms and for some full-time employees in 5% of firms (2 1/2:1). Similarly, life insurance was provided in groups of 33% and 16% (2:1). There were exceptions, however. Employee discounts, a benefit far more prevalent in retail (and to a lesser extent in the wholesale, service, and professional service industries) than other sectors, was most often granted all full-time employees rather than just some. The opposite was true of flex-time, where the proportion providing

the benefit to some was greater than the proportion providing it to all, and education assistance, e.g., paid tuitions. These exceptions reflected the particular circumstances of the benefit provided. For example, it would be difficult in most firms to provide all employees flex-time; the simple necessity of being open at some regularly scheduled period implies some employees will not be eligible.

There were relatively few firms which did not provide access to one or more of the four most common benefits. Table 3 shows that 18% of small employers provided neither paid vacations, paid sick leave, health insurance, nor life insurance. However, the bulk of those

Table 1

PERCENT OF SMALL BUSINESSES PROVIDING SELECTED TYPES OF EMPLOYEE BENEFITS BY BENEFIT TYPE AND PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM

	PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM					
EMPLOYEE BENEFIT	None+	1-39%	40-60%	61-99%	100%	Total
Health Insurance	36	8	5	10	42	100%
Dental Insurance	84	2	1	2	11	100%
Retirement Plan	74	3	2	4	18	100%
Paid Vacations	23	7	3	8	59	100%
Paid Sick Leave	52	7	3	4	34	100%
Long-Term Disability	80	3	2	3	12	100%
Life Insurance	51	6	4	6	33	100%
Education Assistance	77	6	1	3	13	100%
Employee Discounts	61	2	2	3	32	100%
Flex-Time	82	8	3	2	7	100%
Paid Lunch Break	75	4	2	2	18	100%
Dependent Care	95	1	*	1	3	100%
Legal Assistance	97	1	1	*	2	100%

Number of Respondents = 1,439

+ includes no answer
* less than 0.5%

+/ No answers can reasonably be interpreted as a random phenomenon or as a negative response. The former interpretation leads to distributing non-respondents proportionally across all answers; the latter interpretation leads to adding non-respondents to the negative column. The negative response interpretation was selected after reviewing individual questionnaires. It was evident from those documents that the intention of most non-respondents was to indicate a negative answer.

Table 2

PERCENT OF SMALL BUSINESSES PROVIDING THE MOST COMMONLY PROVIDED EMPLOYEE BENEFITS BY COMMON BENEFIT TYPE AND FIRM SIZE

MOST COMMON BENEFITS	FIRM SIZE (FULL-TIME EMPLOYEES) 1-4	5-9	10-19	20-49	50-99	100+	No Answer	Total
Paid Vacations								
Provided All	55	69	70	66	70	85	21	59%
Provided	18	18	22	27	29	16	5	18%
Not Provided	27	13	8	7	2	*	74	23%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Health Insurance								
Provided All	32	51	54	54	58	74	14	42%
Provided	17	28	29	34	36	15	9	23%
Not Provided	51	20	17	12	7	10	87	36%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Paid Sick Leave								
Provided All	35	37	38	36	32	49	12	34%
Provided	11	12	19	22	36	21	5	14%
Not Provided	54	51	43	42	32	31	83	52%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Life Insurance								
Provided All	21	39	46	41	56	80	14	33%
Provided	9	17	23	30	36	21	3	16%
Not Provided	70	44	30	29	9	*	83	52%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Employee Discounts								
Provided All	35	36	33	31	20	36	17	32%
Provided	7	6	10	8	12	3	5	7%
Not Provided	59	59	58	60	68	62	78	61%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Retirement Plan								
Provided All	9	16	28	31	54	56	6	18%
Provided	5	9	11	13	20	13	3	8%
Not Provided	86	76	61	57	26	31	91	74%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Number of Resp.	534	299	209	144	59	39	155	1439

* less than 0.5

without any common benefit fell in the 1-4 employee size class. At the other end of the scale, 63% of those employing more than 50 people provided all four benefits. The majority (52%) of all firms surveyed offered some combination of the four.

If the fifth most common benefit (employee discounts excluded due to their industry specific nature)--retirement plans--were added to the first four (Table 3), the percent with no benefits remained unaffected. But the percent of small businesses with all five benefits fell by more than half. Since the greatest decline occurred among the smallest firms, the number of employees affected was not as large as one might at first presume.

There is some evidence, drawn from Tables 2 and 3, suggesting that small businesses introduced individual employee benefits sequentially. Health insurance followed introduction of paid vacations and so forth. For example, compare the Paid Vacations - "Not Provided" line on Table 2 with the first "None Provided" line on Table 3. Note their similarity.

Table 3

PERCENT OF SMALL BUSINESSES PROVIDING SELECTED COMBINATIONS OF EMPLOYEE BENEFITS BY BENEFIT COMBINATION AND FIRM SIZE

PAID VACATIONS, HEALTH INSURANCE, LIFE INSURANCE, AND PAID SICK LEAVE	FIRM SIZE (FULL-TIME EMPLOYEES)							
	1-4	5-9	10-19	20-49	50-99	100+	No Answer	Total
All Provided	18	31	44	45	63	64	10	30%
Some Provided	60	61	51	49	37	36	21	52%
None Provided	22	8	5	6	*	*	70	18%
Total	100%	100%	100%	100%	100%	100%	100%	100%
PAID VACATIONS, HEALTH INSURANCE, LIFE INSURANCE, PAID SICK LEAVE, AND RETIREMENT								
All Provided	6	12	22	24	53	51	*	14%
Some Provided	73	80	74	70	48	49	27	68%
None Provided	21	8	5	6	*	*	70	18%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Number of Resp.	534	299	209	144	59	39	155	1439

* less than 0.5%

That similarity indicates that paid vacations were the base or floor benefit. It does so simply because the addition of other benefits does not push lower the percentage without any benefits. Using the same logic, compare both "None Provided" lines on Table 3. When pensions were added to the list of benefits, no fewer firms provided at least one of the benefits. That implies pensions as a benefit sequentially followed the other four in introduction. While such ordering is not surprising, it clearly suggests that employers and/or employees maintain a self-imposed benefit hierarchy upon which their decisions are often based.

The cost of voluntary employee benefits, i.e. those benefits not provided by legal compulsion, to those small business employers providing benefits averaged over $2,392 per month or more than $28,700 annually (Table 4). Obviously, the average cost increased as the size of the firm increased. But the estimated cost of benefits per dollar of gross receipts appeared to decline as firm size rose. For example, using mid-points,

Table 4

ESTIMATED MEAN MONTHLY EMPLOYER COST OF VOLUNTARY AND COMPULSORY EMPLOYEE BENEFITS BY SMALL BUSINESS ANNUAL GROSS RECEIPTS

ANNUAL GROSS RECEIPTS ($000's)	Mean Monthly Cost of Voluntary Benefits	Number	Mean Monthly Cost of Compulsory Benefits	Number	Voluntary Benefits As A % of Compulsory Benefits
Under 100	$ 348	64	$ 314	97	111%
100-199	$ 701	110	$ 569	152	123%
200-499	$1,074	190	$1,075	234	100%
500-799	$1,469	128	$1,768	132	83%
800-1,499	$2,081	144	$2,402	140	87%
1,500-2,999	$3,748	120	$3,869	110	97%
3,000-4,999	$4,397	60	$4,627	54	95%
5,000-9,999	$6,291	48	$6,888	44	91%
10,000 or More	NA	47	NA	46	---
No Answer	$2,707	27	$2,272	28	119%
ALL FIRMS	$2,392	938	$2,282	1,037	105%

NA A few large small businesses reported both voluntary and compulsory benefit levels that were considerably "out-of-range." While there is no question of the data's authenticity, additional work is required before they can be reported. Until then, the maximum allowable cost for purposes of calculating an all firms average is $9,999 per month.

voluntary benefit costs for firms annually grossing between $100,000 and $199,999 amounted to an estimated 5.6% of receipts. The percentage fell to 2.5%, 2.0%, and 1.0% as the annual gross receipt class rose from $500,000-$799,999 to $1,500,000- $2,999,999 to $5,000,000-$9,999,999.

The data did not directly provide any rationale for the inverted cost structure. But part of it undoubtedly lay in the greater labor intensity of smaller small businesses. A larger part, however, probably could be attributed to decreasing per unit costs. For example, it will subsequently be shown that the amount of time spent searching for health care options, etc., increased with firm size. More time searching, within bounds, effectively results in lower per unit costs. Such indirect evidence in conjunction with what is already known about economies of scale in purchasing services and regulatory compliance, such as in administration of retirement plans, infers a unit cost hypothesis is probably valid.

Where small businesses voluntarily provided employee benefits, the employer cost of compulsory benefits, i.e. Social Security (FICA), Unemployment Compensation (FUTA), and Workers Compensation, approximated the cost of voluntary benefits (Table 4). Any differences registered on a size class by size class basis were modest. In fact, in one size class, the $200,000 to $499,999 class, average costs of voluntary and compulsory benefits were almost identical.

Not all small businesses provided voluntary employee benefits, however. As a result, the employer cost for compulsory benefits across the entire population became relatively greater than the employer cost for voluntary benefits. This effect was most noticeable in the smaller size classes where the propensity to have voluntary benefits was the least. For example, as noted above, monthly costs of voluntary and compulsory benefits in the $200,000 to $499,999 size class were virtually identical. But assume that just 81% of the class (190 divided by 234, on Table 4) provided voluntary benefits. Then the average monthly cost of voluntary benefits for the entire population tumbles to $872 or 81% of compulsory benefit costs.

Small business owners as a group provided their employees with a wide range of benefits. Some offered them a substantial and costly array of voluntary benefits while others offered only those benefits of a compulsory nature. Yet, no matter how calculated, the total cost of employer paid employee benefits (compulsory and voluntary) to the nation's small business owners was large. It amounted to a significant cost of doing business and there was little reason to believe that that situation would change. Therefore, the two voluntary benefits that are most costly and most subject to legislatively directed change--health insurance and retirement plans--need to be examined more closely.

HEALTH INSURANCE

Sixty-five (65) percent of surveyed small business owners provided health insurance for at least a portion of their full-time employees. Approximately two-thirds (42%) carried it for all and one-third (23%) carried it for some. Provision was directly related to firm size--the larger the firm, the more likely it was to have employee health insurance. This relationship is clear whether firm size is measured in terms of employees (Table 2) or annual gross receipts (Table 5).

Table 5

ANNUAL GROSS RECEIPTS OF SMALL BUSINESSES BY PERCENT OF FULL-TIME EMPLOYEES COVERED WITH EMPLOYER PROVIDED HEALTH INSURANCE
(in percent)

ANNUAL GROSS RECEIPTS ($000's)	PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM					
	None+	1-39%	40-60%	61-99%	100%	Total
Less than 100	81	4	1	2	12	100%
100-199	59	7	5	7	23	100%
200-499	40	10	4	9	38	100%
500-799	26	10	4	13	47	100%
800-1,499	19	8	6	17	51	100%
1,500-2,999	8	7	8	14	63	100%
3,000-4,999	10	11	9	9	62	100%
5,000-9,999	11	4	4	13	70	100%
10,000 or More	6	4	4	17	70	100%
No Answer	38	8	6	9	40	100%
Percent of Respondents	36%	8%	5%	10%	42%	100%
Number of Respondents	517	110	66	149	597	1439

+ includes no answer

Benefits and Conditions

Hospitalization/surgical insurance covers those components of health care provided by a hospital and the "usual, customary, and reasonable" charges for surgical procedures performed. Major medical covers expenses beyond basic hospital and surgical benefits. And, a form of major medical known as comprehensive consists of major medical coverage "plus." These are the general types of health insurance (excluding such additions as dental) from which small employers can choose. Unfortunately, the comprehensive variation was inadvertently omitted from the questionnaire.

limiting somewhat the analysis that could be performed on types of health insurance purchased by small business owners.

Over 80% of all respondents with health insurance reported carrying the most comprehensive benefit coverage listed on the survey, i.e. hospitalization/surgical and major medical (Table 6). Just 8% provided lesser coverage, and 10% either didn't reply or didn't know. There was some evidence that smaller firms were more likely to provide lesser kinds of coverage and vice versa, but the relationship was surprisingly weak.

Table 6

TYPE OF HEALTH INSURANCE PROVIDED SMALL BUSINESS EMPLOYEES BY ANNUAL GROSS RECEIPTS OF SMALL BUSINESSES
(in percent)

INSURANCE TYPE	ANNUAL GROSS RECEIPTS ($000's) Under 200	200-799	800-1,499	1,500-4,999	5,000 or More	No Answer	Total
Hospitalization/ Surgical	2	4	4	2	2	3	3%
Major Medical	8	4	6	5	4	6	5%
Hospitalization/ Surgical and Major Medical	78	79	80	88	88	76	82%
Don't Know/No Answer	13	13	10	6	10	15	10%
Total	100%	100%	100%	100%	100%	100%	100%
Number of Resp.	120	312	159	198	100	33	922

Approximately one-third of those with health insurance did not provide it to all full time employees. ("Non-discrimination" rules allow different benefits or levels of benefits to be provided to different employee groups under specified conditions.) Table 7 reviews the conditions upon which some full-time employees were excluded from the plan. In almost half of the cases, a specified number of years on the job was the basis for inclusion/exclusion. (Later, the relationship between employee turnover and coverage will be visited.) Level of responsibility was the second most frequent point of distinction.

Eighty-six (86) percent provided an option for dependent coverage; just 3% indicated no dependent coverage was available. Those without dependent coverage tended to be among the smaller firms and vice versa. However, in no size class did the dependent coverage option fall below 74%.

Only 8% of those carrying insurance provided part-time employees with the same health benefits as provided full-time employees. Virtually none provided a reduced level of coverage for part-time employees, illustrating

Table 7

SELECTED CONDITIONS OF EMPLOYEE HEALTH INSURANCE COVERAGE BY INDUSTRY
(in percent)

SELECTED CONDITIONS	INDUSTRY										
	Con	Mfg	Trn	Whl	Ret	Agr	Fin	Ser	Prf	N/A	Total
Basis for Coverage+											
Years on the Job	22	13	11	6	15	28	6	14	9	29	14%
Certain Wage or Salary Level	3	2	3	2	4	6	*	7	*	14	3%
Age	*	2	*	1	2	3	3	3	*	14	2%
Level of Responsibility	8	4	11	5	10	14	3	7	3	43	7%
Other	7	3	8	5	4	*	10	8	5	*	5%
None	60	76	67	81	65	49	78	61	83	*	69%
Option for Dependent Coverage											
Yes	86	92	87	89	82	72	91	79	91	86	86%
No	1	1	*	2	6	11	1	7	5	*	3%
No Answer	13	7	13	9	12	17	7	14	5	14	11%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Part-Time Employee Coverage											
No Part-Time Employees	32	23	32	17	9	11	16	22	11	14	18%
No Coverage	27	41	32	42	46	50	30	46	41	57	40%
Less Coverage Than Full-Time	*	3	*	2	1	*	*	1	*	*	1%
Same Coverage As Full-Time	8	4	3	6	10	8	10	9	20	*	8%
No Answer	34	30	34	34	35	31	44	22	29	29	33%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Number of Resp.	120	155	38	103	226	36	81	90	66	7	922

+respondent could mark more than one answer
* less than 0.5%
N/A no answer

the impracticality for most small businesses of carrying more than one coverage. Given the fact that 18% had no part-time employees, the number covered was actually higher than 8%. However, it is clear that comparatively few part-time employees working in small businesses received employer-sponsored health insurance benefits.

While the survey could not obtain more specific data on the level of health insurance provided, it appeared that once offered, the quality of insurance provided was reasonably uniform. There seemed to be little progression in benefit levels. In other words, a small business apparently did not initially offer minimal coverage, e.g., hospitalization only, and then move toward a better plan for benefit progression. Rather inclusion and exclusion of employees appeared to substitute. Though further evidence will be needed to confirm (or refute) this observation, temporarily assuming its accuracy, the second order question quickly becomes whether the employer decision is purposeful or whether insurance pricing is structured to force the decision.

Trends in Coverage

Health insurance coverage appears to be increasing in the nation's small businesses, though the proportion of small business employees covered remains significantly less than the proportion covered in large and mid-sized enterprises. The 65% of responding small business owners now reporting at least some full-time employee coverage (See Table 2) represented an eight percentage point increase from 1978 when a similar survey reported 57% coverage.*/ The retail, finance, and professional services industries were largely responsible for the rise (Table 8). All three industries experienced increases from the 1978 survey of more than 10 percentage points. Transportation/Communication also appeared to have experienced a considerable increase, but the sector's small sample size (n=37 and n=53) allowed no conclusions. The troubled agricultural industry was the only sector which reduced coverage over the period.

Since the retail, finance, and professional service industries tend to consist of firms smaller than average, the increased number of firms now providing employee health insurance can also be tied to greater coverage among smaller firms. Unfortunately, a direct comparison of coverage by firm size as measured in annual gross receipts is almost meaningless. With the Consumer Price Index having risen by 66% over the period, inflation has changed the value of a specified level of gross too much to compare response classes. However, it can be observed that the largest firms were no more inclined to provide health insurance in 1985 than they were in 1978, and perhaps even a little less. By elimination, the smallest firms then were those left to account for the greater coverage.

*/ National Health Insurance Report for Small Business (National Federation of Independent Business: San Mateo, CA), June, 1978.

Table 8

PERCENT OF SMALL BUSINESSES PROVIDING EMPLOYEE HEALTH INSURANCE BY INDUSTRY - 1978 AND 1985

INDUSTRY	YEAR 1978	YEAR 1985	PERCENT CHANGE 1978-1985
Construction	66	73	+11
Manufacturing	81	83	+2
Transportation	60	73	+22
Wholesale	73	73	0
Retail	46	58	+26
Agriculture	52	48	-8
Financial Services	56	65	+16
Services	48	52	+8
Professional Services	49	62	+27
ALL FIRMS	57%	65%	+14

The overall quality of health insurance plans, i.e. coverages, costs, deductibles, etc. appeared to have also changed. Unfortunately, a comparison between quantity (number with plans) and quality (composition of plans) is difficult at best, but it is exacerbated by the data available. Quantity for present purposes was measured over a seven-year interval employing two different surveys Quality was measured over a three-year interval employing one survey and the recall of respondents. Complicating matters, changes in the first four years were probably significantly different from those in the last three.

Despite these data limitations, small business owner responses in 1985 suggested considerable change in the characteristics of health benefits provided over the past three years, though on balance only modest improvement (Table 9). For example, the number increasing the percentage of employees covered was three times as great as the percentage decreasing. Benefits were increased by 26% compared to 14% reducing them. But the size of deductibles rose in 38% of the cases; co-insurance requirements rose as well. Costs (premiums) for both employers and employees rose, but employers were far more likely to have experienced one. In fact, three of four reported their premium cost higher than three years prior, but just one of four reported the employee premium cost higher. As many as 36% failed to respond to aspects of change in health insurance coverage. Since only responses from those with coverage three years ago were counted, it would appear that many owners were not familiar with the details of the plan they provide.

Table 9

PERCENT OF SMALL BUSINESSES EXPERIENCING CHANGES IN EMPLOYEE HEALTH INSURANCE COVERAGE OVER PAST THREE YEARS
(Excluding firms not in business or without coverage three years ago)

	HEALTH INSURANCE CHANGES				
COVERAGE	Decrease	No Change	Increase	No Answer	Total
Percent of Employees	5	53	20	22	100%
Benefits	14	39	26	21	100%
Premium Cost (employer's)	4	6	75	16	100%
Premium Cost (employee's)	2	38	27	33	100%
Deductibles	4	35	38	23	100%
Co-Insurance Requirements	1	52	11	36	100%

Number = 828

Costs

It is not news that health insurance premiums are expensive. The average firm purchasing insurance spent approximately $1,750 per month for coverage--more than double the sum spent in 1978 (Table 10). (Health care costs rose 84% over the period.) Moreover, health insurance premiums amounted to a substantial portion of the total cost of an employee's benefit package. Compare the data on Table 10 to the data on Table 4 (produced here as Table 11). Note that the mean monthly health insurance cost was $1,766 and the estimated mean monthly benefit cost was $2,392. That implies health insurance accounted for nearly 75% (in costs) of total voluntary benefits provided. That comparison can be misleading, however. The potential for deception is best illustrated in the less than $100,000 annual gross receipts classification where the health premiums were larger than the total amount of voluntary benefits. The reason was that the total benefit figure was based on the 938 respondents; the total health premium figure was based on the 794 respondents. Nevertheless, it is clear that health insurance costs constituted a very large share of a small business's employee benefits package no matter how it is measured.

Table 12 places these health insurance cost figures in a more understandable form. The median (50% above-50% below) small employer cost of insurance per employee lay between $75 and $99 per month. However, the average was drawn higher due to the nearly 20% absorbing a monthly cost of $150 or more. The median cost per employee with dependent coverage amounted to somewhat more than $125.

Table 10

MEAN MONTHLY EMPLOYER HEALTH INSURANCE
PREMIUMS COSTS BY SMALL BUSINESS
BY ANNUAL GROSS RECEIPTS
AND SMALL BUSINESS INDUSTRY - 1978 and 1985

1978 ANNUAL GROSS ($000's)	1978 Mean Monthly Premium	1985 Mean Monthly Premium	1985 ANNUAL GROSS ($000's)
Under 50	$ 167		
50-99	$ 168	$ 460	Under 100
100-199	$ 327	$ 383	100-199
200-349	$ 396		
		$ 718	200-499
350-799	$ 558		
		$ 974	500-799
800-1,499	$ 958	$1,137	800-1,499
1,500 or More	$2,268		
		$2,435	1,500-2,999
		$3,134	3,000-4,999
		$4,871	5,000-9,999
		NA	10,000 or More
ALL FIRMS	$ 838	$1,766	ALL FIRMS

INDUSTRY	1978 Mean Premium	1985 Mean Premium	Percent Change 1978 to 1985
Construction	$ 868	$1,492	72%
Manufacturing	$1,805	$3,552	97%
Transportation	$ 538	$1,624	202%
Wholesale	$ 833	$1,898	128%
Retail	$ 504	$1,090	116%
Agriculture	$ 677	$1,426	111%
Financial Service	$ 836	$1,346	61%
Services	$ 541	$1,469	172%
Professional Service	$ 451	$1,445	200%
ALL FIRMS	$ 838	$1,766	111%

NA A few relatively large businesses reported health insurance premiums that were considerably "out of range." Treatment of these data is outlined in Table 4.

Part of the reason small employers faced such large health insurance costs was that more than 2/3 paid the entire premium, and a whopping 87% paid more than half (Table 13). (Both figures cited adjust for the 10% no answer.) Curiously, 72% of those with insurance and annually grossing $100,000-$199,999 picked up 100% of the premium (over 80% adjusting for no answer). The figure fell into the 60's among those firms grossing $200,000 to $4,999,999, then into the 40's among firms grossing more than $5,000,000. This somewhat surprising distribution may be the result of administrative costs and bother in deducting the employee's share when

Table 11

ESTIMATED MEAN EMPLOYER COST OF VOLUNTARY BENEFITS AND HEALTH INSURANCE BY SMALL BUSINESS ANNUAL GROSS RECEIPTS

ANNUAL GROSS RECEIPTS ($000's)	Mean Monthly Cost of Voluntary Benefits	Number	Mean Monthly Cost of Health Insurance	Number	Per Firm Health Insurance As A % of All Voluntary Benefits[1]	Population Health Insurance As A % of All Voluntary Benefits[2]
Under 100	$ 348	64	$ 460	30	132%	62%
100-199	$ 701	110	$ 383	78	55%	39%
200-499	$1,074	190	$ 718	154	67%	34%
500-799	$1,469	128	$ 974	107	66%	55%
800-1,499	$2,081	144	$1,137	148	55%	---
1,500-2,999	$3,748	120	$2,435	117	65%	63%
3,000-4,999	$4,397	60	$3,134	55	71%	65%
5,000-9,999	$6,291	48	$4,871	40	77%	64%
10,000 or More	NA	47	NA	40	---	---
No Answer	$2,707	27	$2,080	25	77%	71%
ALL FIRMS	$2,392	938	$1,766	794	74%	63%

[1]Calculated by dividing the mean monthly cost of health insurance by the mean monthly cost of voluntary benefits.

[2]Calculated by dividing the sum of health insurance costs in each size class (not shown) by the number in each size class reporting a voluntary benefits cost. The result was divided by the mean monthly employer cost of voluntary benefits.

NA A few relatively large small businesses reported both voluntary benefit levels and health insurance premiums that were considerably "out of range." Treatment of these data is outlined in Table 4.

few employees are affected; wages can be adjusted more easily. It also might reflect an emulation by small businesses with greater than 50 employees of large and medium sized enterprises where the trend has been toward a reduced employer share.

Carriers and Sponsors

A majority (53%) of small business owners carried their health insurance with a private carrier other than Blue Cross/Blue Shield (Table 14). From the comparatively few respondents specifying one of these carriers, the Travelers appeared to serve the largest number. The "Blues" carried 24%. Self-insurance (4%) and HMO's (3%) remained an oddity. Sixteen (16) percent did not respond. With the exception of self-insurance, which naturally was confined to those with $5 million or more in annual gross receipts, the carrier seemed unrelated to either industry or firm size.

The firm itself was the most frequent group sponsor (45%), followed by trade or business associations (27%) (Table 14). But among some industries, there was a far greater propensity to have association sponsored plans than among others. For example, owners of professional service and financial service firms procured their employee health

Table 12

PERCENTAGE DISTRIBUTION OF EMPLOYERS' COSTS IN PROVIDING HEALTH INSURANCE FOR INDIVIDUAL EMPLOYEES AND DEPENDENTS

	Individual Employee			Employee and Dependents	
EMPLOYER'S SHARE OF MONTHLY PREMIUM PER EMPLOYEE	Total	Total-N/A Excluded	EMPLOYER'S SHARE OF MONTHLY PREMIUM PER EMPLOYEE	Total	Total-N/A Excluded
$ 0-9	1	2	$ 0-24	9	11
$ 10-24	2	3	$ 25-49	3	4
$ 25-49	10	13	$ 50-74	8	10
$ 50-74	20	26	$ 75-99	7	9
$ 75-99	16	20	$100-124	10	13
$100-124	8	11	$125-174	17	23
$125-149	5	6	$175-224	12	15
$150 or more	15	19	$225 or more	11	14
No Answer	23	--	No Answer	23	--
TOTAL	100%	100%	TOTAL	100%	100%
Number of Resp.	992	713	Number of Resp.	922	706

Table 13

ANNUAL GROSS RECEIPTS OF SMALL BUSINESSES PROVIDING EMPLOYEE HEALTH INSURANCE BY EMPLOYEE SHARE OF HEALTH INSURANCE PREMIUM
(in percent)

	EMPLOYEE PREMIUM SHARE							
ANNUAL GROSS RECEIPTS ($000's)	None	1-24%	25-49%	50-74%	75-99%	100%	No Answer	Total
Under 100	63	9	6	6	*	*	17	100%
100-199	72	8	4	2	1	1	11	100%
200-499	62	5	8	10	*	2	13	100%
500-799	64	8	9	3	1	3	11	100%
800-1,499	62	9	10	8	1	1	8	100%
1,500-2,999	67	9	7	10	2	1	5	100%
3,000-4,999	63	9	8	9	2	2	8	100%
5,000-9,999	44	10	20	14	*	*	12	100%
10,000 or More	44	12	14	18	*	2	10	100%
No Answer	46	12	15	6	*	3	18	100%
Percent of Resp.	62%	8%	9%	9%	1%	1%	11%	100%
Number of Resp.	567	76	83	78	7	13	98	922

* less than 0.5%

insurance through trade associations with twice the frequency as did owners of manufacturing and agricultural firms (Table 15). No immediate explanation for these differences was apparent. The most obvious, firm size which was directly related to industry, showed no relationship to group sponsor. The comparative strength or marketing capacity of varying trade groups may provide the answer, but the survey did not collect information regarding association membership.

Table 15 provides evidence of a major shift in group sponsors over the past seven years. The trade association has been increasing in importance at the direct expense of the individual firm. In fact, proportionately distributing no answers as was done on Table 15, the net increase in firms providing health insurance was almost identical to the net increase in the number of firms with an association sponsor. But the results were mixed when assessing whether or not the trend toward trade associations as sponsors has been a factor in increasing insurance coverage in those industries principally responsible for the overall small business increase. Recall that it was growth in the financial services, professional services and retail as well as smaller firms that were largely responsible for the increase in the number of firms covered between 1978 and 1985. Neither the retail nor the financial services

industries shifted group sponsorship to to the degree the total population did. Professional services, however, showed the most radical shift to association sponsorship (19 percentage points). Unfortunately, a comparison with 1978 could not be made since that data could not be recaptured. Another piece of data -- the reduced incidence of smaller firms citing an inability to obtain group insurance -- also suggests that trade associations may have been helpful to the smallest firms.

Table 14

INSURANCE CARRIER OF SMALL BUSINESSES PROVIDING EMPLOYEE HEALTH INSURANCE BY GROUP SPONSOR
(in percent)

	GROUP SPONSOR					
INSURANCE CARRIER	Firm	Trade Assoc.	Self-Insured	Other	No Answer	Total
HMO	4	2	3	*	2	3%
Self-Insured	1	4	46	*	2	4%
Blue Cross/ Blue Shield	31	26	14	9	12	24%
Other Private	60	65	37	87	24	53%
No Answer	4	4	*	4	61	16%
Total	100%	100%	100%	100%	100%	100%
Number of Resp.	414	251	35	23	199	922

* less than 0.5%

Satisfaction With Insurance

Almost 2/3 (66%) of the small employers providing at least some health insurance coverage were generally satisfied with the plan made available to their employees (Table 16). While at first blush a 66% satisfaction rating would seem favorable, it was 16 percentage points lower than the 1978 evaluation. The change from 1978 should not be surprising given the very large increases in premiums paid (see Table 11). Note, for example, that the percent indicating "not satisfied, but can't afford a better plan" rose seven percentage points over the period. In addition, Table 17 shows that those with less costly plans were more often satisfied than were those with more expensive plans.

Satisfaction appeared unrelated to either the plan carrier or the group sponsor. But as expected, satisfaction was related to the amount of time spend investigating health insurance options, health care cost reduction alternatives, etc. The more dissatisfied the small business

Table 15

PERCENTAGE DISTRIBUTION AND CHANGE IN DISTRIBUTION OF GROUP SPONSORING SMALL BUSINESS EMPLOYEE HEALTH INSURANCE - 1978 AND 1985

GROUP SPONSOR	YEAR 1978*	YEAR 1985@	PERCENT CHANGE 1978-1985
Firm	70	57	-19
Trade Association	25	35	+40
Construction	(23)	(36)	(+57)
Manufacturing	(11)	(21)	(+91)
Transportation	(33)	(37)	(+12)
Wholesale	(24)	(40)	(+67)
Retail	(33)	(36)	(+ 9)
Agriculture	(19)	(25)	(+32)
Financial Services	(43)	(47)	(+ 9)
Services	(29)	(30)	(+ 3)
Professional Services	(33)	(52)	(+58)
Other	5	8	+60
TOTAL	100%	100%	--

* estimated from data in 1978 report
@ distributing a 22% no response
() subtotals

owner was with his insurance, the more time he spent looking for alternatives. However, a variety of factors intervened to reduce the strength of the satisfaction/search relationship.

Searching for Health Care

Small business owners are busy people; their time is often their greatest asset. Thus, it should not be startling that few small business owners personally spent much time searching for health insurance options, means to control health care costs, etc. But it is startling that neither they nor a designated employee spent much time considering options to th rapidly escalating cost of health insurance and health care.

The median time spent (owner or designated employee) investigating health care options within the last 12 months was about four hours or one-half day (Table 18). Clearly, those that had coverage spent more time than those who did not, but not by the margin one might have expected. Moreover, those covering a greater proportion of full-time employees did not spend appreciably more time than did those covering a lesser proportion.

Table 16

PERCENTAGE DISTRIBUTION OF SMALL BUSINESS OWNER SATISFACTION WITH EMPLOYEE HEALTH INSURANCE - 1978 AND 1985

SATISFACTION	YEAR 1978	1985
Generally Satisfied	82	66
Not Satisfied, Can't Afford Better	9	16
Not Satisfied, Soon Will Have Better	2	3
Soon Will Reduce Coverage	*	1
Soon Will Drop Coverage	N/A	*
Subject to Union Agreement	3	2
No Answer	4	11
TOTAL	100%	100%

* less than 0.5%
N/A not asked

The most noticeable cell on Table 18 is the one indicating that 41% of those without insurance spent less than one hour within the last year looking at health care options. This group probably consisted for the most part of those not interested in locating coverage. But, there were also many who spent a reasonable time searching and simply could not find something to meet their needs.

The amount of time spent searching was clearly reduced by the dependence on outside advisors. In the overwhelming majority of instances (over 60%), small business owners relied on outside professionals to provide them information on health insurance and health case costs, options, etc. The single most important source of that information, and by overwhelming margins, was the insurance agent. Forty-four (44) percent of all respondents cited this source, followed by trade associations (16%), insurance brokers (15%), magazines/publications (4%), health care providers (2%), business consultants (2%), and other (1%); 16% did not respond (Table 19). Curiously, the amount of owner/employee time spent searching increased with reliance on brokers and consultants, but decreased with reliance on agents. The opposite would have been expected. Brokers and consultants effectively become employees when engaged for certain purposes; their incentive is to reduce client costs. The incentive for agents is somewhat different.

Table 17

SMALL BUSINESS OWNER SATISFACTION WITH EMPLOYEE HEALTH INSURANCE PLAN BY EMPLOYER'S COST
(in percent)

	EMPLOYER'S COST PER INDIVIDUAL ($'s)					
SATISFACTION	Less Than 50	50-99	100-149	150 or More	No Answer	Total
Generally Satisfied	78	76	66	65	44	66%
Not Satisfied, Can't Afford Better	19	16	21	18	11	16%
All Others	2	5	7	15	6	6%
No Answer	*	4	6	2	39	11%
Total	100%	100%	100%	100%	100%	100%
Number of Respondents	127	330	122	134	209	922

* less than 0.5%

Table 18

SMALL BUSINESS OWNER OR EMPLOYEE HOURS SPENT INVESTIGATING HEALTH CARE OPTIONS IN LAST 12 MONTHS BY PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM
(in percent)

	PERCENT OF FULL TIME EMPLOYEES COVERED IN EACH FIRM					
HOURS SPENT IN LAST 12 MONTHS INVESTIGATING	None+	1-39%	40-60%	61-99%	100%	Total
Less Than One	41	28	24	13	19	27%
1-4	14	19	18	20	20	18%
5-8	9	16	15	18	14	13%
9-16	5	13	12	17	13	11%
17-24	2	3	5	4	7	4%
25-40	3	6	11	11	8	7%
41-80	1	4	5	7	6	4%
81 or More	*	2	*	1	5	3%
No Answer	25	11	11	9	6	14%
Total	100%	100%	100%	100%	100%	100%
Number of Resp.	517	110	66	149	597	1439

* less than 0.5%
+ includes no answer

Minimum Coverage Requirements

At least 20 states now require that any business providing employee health insurance include minimum levels of coverage for particular health conditions. For example, Massachusetts mandates that employer based health insurance include certain levels of mental health coverage. While still reasonably new, a question arises on the impact or influence of such public policy given that economic causes are frequently cited for non-coverage.

Table 20 illustrates that comparatively few small employers recognized that minimum coverage requirements exist. Just 6% reported their state had such requirement; 26% didn't know if their state did or not. Grouping the states with minimum coverage and those without, then distributing the small business population among them, the percent recognizing the requirement was only a fraction of those to which it applied and for which they were paying. The reason so few recognized those minimum coverage requirements is obvious. The additional coverage is wrapped in the new policy and given to the small business owner on a "take it or leave it" basis.

Table 19

MOST IMPORTANT HEALTH COST INFORMATION SOURCE FOR SMALL BUSINESS OWNERS BY HOURS SPENT INVESTIGATING HEALTH CARE OPTIONS IN LAST 12 MONTHS
(in percent)

MOST IMPORTANT INFORMATION SOURCE	HOURS SPENT INVESTIGATING IN LAST 12 MONTHS						
	Less Than One	1-4	5-8	9-16	17 or More	No Answer	Total
Insurance Agent	51	55	54	47	42	10	44%
Insurance Broker	7	15	19	24	30	3	15%
Trade Association	18	21	15	16	16	4	16%
Health Care Providers	3	1	4	1	2	2	2%
Magazines/ Publications	5	4	3	4	4	1	4%
Business Consultant	1	*	2	3	4	1	2%
Other	2	*	*	1	1	*	1%
No Answer	13	3	2	4	1	80	16%
Total	100%	100%	100%	100%	100%	100%	100%
Number of Resp.	395	256	184	152	255	197	1439

* less than 0.5%

Of the 6% recognizing minimum coverage requirements, two of three indicated they did not change coverage in response. The next largest group expanded coverage to comply, with only a smattering claiming to have either shifted or dropped coverage. But the sample numbers are far too small to make any generalizations.

Table 20

PERCENTAGE DISTRIBUTION OF SMALL BUSINESS OWNER AWARENESS OF AND CONSCIOUS RESPONSES TO STATE MINIMUM COVERAGE REQUIREMENTS

MINIMUM CHANGE REQUIREMENTS	AWARENESS OF REQUIREMENTS	CONSCIOUS RESPONSES
Yes	6	
No Change in Coverage		66
Coverage		22
Shifted Coverage		4
Dropped All Coverage		1
Doesn't Affect Me		1
No Answer		6
Subtotal		100%
No	68	
Don't Know	26	
TOTAL	100%	

Non-Coverage

Despite the increased number of small business owners providing employee health insurance, over one-third provided none; others did not provide it for all employees. The reason(s) for pursuing the no insurance option were neither surprising nor irrational. While no single reason dominated, almost all fell under the general headings of work force composition or cost.

"Generally covered under a spouse or parent policy" was the single most frequently given reason (29%) (Table 21). In other words, the employee mix consisted of significant proportions of secondary wage earners. Covering this group presumably increases labor costs without providing any additional benefits to employees. Table 21 reveals that the secondary wage earner issue was the primary reason firms with coverage often did not include all employees in the benefit. "Employee turnover too great," a second labor force composition reason, was more frequently cited by larger employers (Table 22). Recall that in the previous discussion of benefit conditions, employee tenure was the most frequently used method to separate eligibility for health insurance benefits where such separation existed (Table 6).

Table 21

SMALL BUSINESS OWNER REASONS NOT TO PROVIDE HEALTH INSURANCE TO ALL FULL-TIME EMPLOYEES BY PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM
(in percent)

REASON	PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM				
	None+	1-39%	40-60%	61-99%	Total@
Premiums Too High	33	29	14	7	27%
Employee Turnover Too Great	15	21	18	8	15%
Generally Covered Under A Spouse or Parent Policy	26	29	33	26	29%
Never Thought About It	2	*	*	*	1%
Administrative Expenses Too High	8	5	2	1	6%
Employees Prefer Compensation	8	10	6	5	8%
Firm Insufficiently Profitable	20	10	11	2	15%
Can't Qualify For Group Policy	19	4	2	2	12%
Other	4	7	*	4	4%
Total@	135%	115%	86%	55%	117%
Number of Respondents	517	110	66	149	842

+ includes no answer
* less than 0.5%
@ respondents could mark more than one answer

It was often a simple matter of economics for employers who provide no health insurance. Half of those without insurance either attributed their action to premiums being too high (33%) or to insufficient profitability (20%)--opposite sides of the same proposition. Not surprisingly, these economic reasons were most pronounced among those with coverage for no full-time employees.

Another 19% said the firm could not qualify for group coverage, which implies another variant of the cost problem. The inability to qualify as a group (real or perceived) was focused among the respondents employing 1-4 people (Table 23). Sixteen (16) percent of the very smallest employers cited it. Moreover, almost all who believed they could not qualify for group coverage indicated the reason was business size.

Despite additional response categories in the 1985 survey, the distribution of reasons for not having employee health insurance in 1985 was similar to distribution in 1978. The two reasons most frequently cited in 1978 were the two most frequently cited in the current survey.

Table 22

SMALL BUSINESS OWNER REASONS NOT TO PROVIDE HEALTH INSURANCE TO ALL FULL-TIME EMPLOYEES BY FIRM SIZE
(in percent)

REASON	FIRM SIZE (FULL-TIME EMPLOYEES) 1-4	5-9	10-19	20-49	50+	No Answer	Total*
Premiums Too High	32	32	30	21	11	14	27%
Employee Turnover Too Great	16	16	15	24	26	7	15%
Generally Covered Under A Spouse or Parent's Policy	33	32	40	23	14	11	29%
Never Thought About It	2	*	*	*	*	2	1%
Administrative Expenses Too High	7	6	5	3	6	4	6%
Employees Prefer Compensation	7	10	10	9	6	4	8%
Firm Insufficiently Profitable	20	12	9	6	9	13	15%
Can't Qualify For Group Policy	16	5	6	2	*	18	12%
Other	2	1	3	9	11	10	4%
Total@	135%	114%	118%	97%	83%	83%	117%
Number of Respondents	365	146	97	66	35	133	842

* less than 0.5%
@ respondents could mark more than one answer

A nuance in this regard was that those attributing their action to a predominance of secondary wage earners fell twelve percentage points to 26%. There is no immediate explanation for the fall. Small declines were also registered for employee turnovers and can't qualify for a group.

Given the reasons for not currently providing employee health insurance, stimulants to provide it were predictable. Lower rates and greater profitability were the two most frequently noted (Table 23). "Business got bigger," "qualify as a group," and "employees asked for it" followed at a distance. Just 4% of those not providing coverage for all full-time employees, or 3% of the entire sample, indicated they would not provide health insurance under almost any circumstance. That is about the same as the number providing the identical response in 1978.

Concluding Observations

The survey did not (and probably could not) obtain data on the level of health insurance benefits provided. However, the evidence available

suggests that benefits are surprisingly consistent or uniform given the varying conditions of the small businesses and small business owners surveyed. For example, almost all providing insurance carried hospitalization/surgical and major medical; virtually none provided lesser degrees. Similarly, virtually all had a dependent care option. While a broad distribution of monthly per employee costs was apparent, arguing against a uniformity thesis ("you get what you pay for"), the principal distinction seemed to occur between those employees covered and those employees not covered. Recall that no employees were offered health insurance in 36% of the firms and only selected employees were offered health insurance in 23% of firms. Given those conditions and the economic reasons many small employers gave for not offering health insurance, it is curious that the distribution of benefits is not much greater than it appears. This situation raises two related points. The first is whether the employer's decision to provide "all or nothing" coverage is purposeful

Table 23

CAUSES FOR SMALL BUSINESS OWNERS TO PURCHASE HEALTH INSURANCE FOR ALL FULL-TIME EMPLOYEES BY PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM
(in percent)

	PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM				
CAUSE TO PURCHASE	None+	1-39%	40-60%	61-99%	Total*
Qualify as a Group	16	5	*	3	11%
Business Became More Profitable	24	23	11	4	23%
Rates Were Lower	36	23	17	9	28%
Minimum Coverage Requirements Dropped	5	5	2	1	4%
Rates and Coverages More Stable	8	5	3	2	6%
Business Got Bigger	19	11	6	3	14%
More Difficult to Find Good Employees	6	6	6	3	6%
Employees Asked For It	10	15	3	8	9%
Wouldn't Provide Under Almost Any Circumstance	5	3	2	1	4%
Total@	129%	96%	50%	34%	105%
Number of Respondents	690	105	32	44	871

+ includes no answer
* less than 0.5%
@ respondents could mark more than one answer

or whether insurance pricing is structured to force a decision. The second is that public policy actions to include minimum coverage requirements serve to increase the gap between those covered and those not covered.

The dependence on outside advisors for health-related matters appears unusually high given the costs involved. Assuming these appearances are not deceiving, an entire series of questions then arise. For example, why is more responsibility delegated on health care to an "outsider" than it probably is on other purchasing decisions? Is it to the owner's and/or employees' benefit? What effect does it have on coverage patterns? This survey was not intended to answer such questions, but they are important ones that need to be addressed at some point.

There is no reason to expect a significant increase in the number of firms providing employee health insurance such as the one experienced between 1978 and 1985. However, some rise might be expected. On the plus side, reductions in health care cost increases should translate into more reasonable insurance costs (though they still are rising faster than inflation). A second plus is that trade associations show every sign of maintaining, if not increasing, their insurance-related activities. Association activity should continue to provide smaller and often less affluent firms access to group coverage. The third factor is that health insurance is increasingly accepted as a condition of employment; the market from this perspective is pushing greater direct coverage. But on the negative side, small business profitability was high in 1978 and reasonably high in 1985 (it peaked about a year and one-half earlier). It is doubtful similar favorable economic conditions can stimulate much broader coverage. Poorer conditions could do the opposite. In addition, there will always be differences in profitability, meaning there will always some firms with an affordability problem. Those negative reasons are on top of the employee related causes for not providing insurance. With the increasing use of part-time labor and secondary wage earners, the incentive to provide health insurance is declining; the market from this perspective is promoting less direct coverage. Thus, there are cross-currents which will influence small business owners' decisions on health care. On balance, these factors point to greater coverage, but not much greater.

RETIREMENT PLANS

One in four (26%) small businesses provided some type of employee retirement plan. In 70% of those instances (18% of the total population), all full-time employees were included in the benefit; in 30% of those instances, just some full-time employees were eligible.

The most common type of retirement plan was the defined contribution plan (Table 24). Thirty-nine (39) percent reported using that kind, although a disproportionate number of no answers (30%) almost certainly should have fallen in the class. The defined benefit type of plan was possessed by 27%; the multiemployer type was characteristic of just 5%.

Since multiemployer plans are closely related to union contracts and previous work indicates less than 5% of small businesses have any union employees, it is likely few if any non-respondents would need to be apportioned to that variety of retirement plan.

The most common form of defined contribution plan was profit sharing (Table 24). Profit sharing was reported by just over half of those identifying the type of defined contribution plan they possess. The money purchase variety was used by about half the number that used profit sharing. Simplified Employee Plans (SEP) and 401(k) plans were virtually the only others identified. Respondents were also presented the Thrift, Keogh, and ESOP options, but so few identified one of those plans as theirs that such plans are henceforth clumped under the heading "Other."

Table 24

TYPE OF SMALL BUSINESS PROVIDED EMPLOYEE RETIREMENT PLAN BY PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM
(in percent)

	PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM				
TYPE OF PLAN	1-39%	40-60%	61-99%	100%	Total
Multi-Employer	8	14	4	3	5%
Defined Benefit	14	32	19	31	27%
Defined Contribution	24	23	43	41	39%
Profit Sharing	14	32	32	39	35%
Money Purchase	14	18	19	16	16%
401(k)	3	5	4	7	6%
SEP	11	9	6	5	6%
Thrift	3	5	*	1	1%
Keogh	5	*	*	4	1%
ESOP	*	*	2	1	2%
Other/No Answer	50	31	37	27	29%
Subtotal	100%	100%	100%	100%	100%
No Answer	54	32	35	25	30%
Total	100%	100%	100%	100%	100%
Number of Respondents	37	22	54	263	376

*Less than 0.5%

Many small business owners providing some type of employee retirement plan were either unfamiliar with the terminology employed in the questionnaire or have delegated responsibility for such activity to the extent that familiarity with the terminology appears unnecessary. Thirty (30) percent of those with a plan could not or would not identify it by basic type. Curiously, respondents from firms employing 50 or more people were less likely to know their plans by name than were those from smaller firms, indicating greater delegation or reliance on advisors.

While a profit sharing plan is normally considered to be a type of defined contribution plan, small business owner respondents do not necessarily consider it as such. In fact, there were almost as many who marked profit sharing as marked defined contribution. The implication is that profit sharing is often an additional benefit not specifically considered to be a retirement benefit.

Conditions

Where retirement plans were offered, they normally were offered to all full-time employees. But in those cases where coverage was not complete, there appeared no discernable trend between those covering just salaried workers and those covering just hourly employees (Table 25). Typically, an employee became eligible to participate in the plan after one year of service. Sixteen (16) percent had a shorter service requirement; 21% had one that was longer. Technically, a service requirement of more than one year is not legal under ERISA. However, most responses of that nature fell under non-covered informal profit-sharing arrangements. There probably was also some confusion with vesting.

The vesting period, i.e. the period of service prior to eligibility for benefits, was surprisingly brief. Only 31% (42% of those answering the question) possessed a vesting period of more than five years. Twelve (12) percent had none, indicating both direct payments to employee savings plans, e.g., IRA's, and perhaps some confusion with service requirements. If nothing else, this distribution of responses indicates the polarized forms small business employee retirement plans take. On the one side, there are highly formal plans of the type that any professional pension manager would recognize and feel comfortable handling. On the other, there are very informal plans which may not be a plan at all under any professionally accepted definition, but which serves the same purpose.

Responses of small business owners having defined benefit and defined contribution plans were similar in two of the three participation requirements outlined above. Both had similar employee type and employee service restrictions. The "odd men out" were those with multiemployer plans. Multiemployer plans were much more likely to affect only one class of employee, but had generally lesser service requirements. When it came to the vesting period, however, responses of those with defined benefit and multiemployer plans appeared similar. Those with defined contribution plans exhibited substantially greater variance. The reason

for the difference is the greater formality or rigidity of the two former plan types and the greater informality or flexibility of the latter.

Table 25

SELECTED PARTICIPATION FACTORS IN SMALL BUSINESS PROVIDED EMPLOYEE RETIREMENT PLANS BY TYPE OF RETIREMENT PLAN

PARTICIPATION FACTORS	TYPE OF PLAN				
	Multi-Employer	Defined Benefit	Defined Contribution	No Answer	Total
Employee Type					
All Full-Time	42	78	86	47	70%
Salaried Only	6	5	3	3	4%
Hourly Only	35	3	1	1	3%
No Answer	18	15	9	50	23%
Total	100%	100%	100%	100%	100%
Employee Service					
No Requirement	18	54	8	5	6%
Less Than 1 Year	24	8	11	3	8%
1 Year	37	48	49	38	45%
2 Years	*	4	7	4	5%
3 Years or More	*	15	16	12	14%
No Answer	18	19	8	47	24%
Total	100%	100%	100%	100%	100%
Vesting Period					
No Requirement	6	8	17	10	12%
1-2 Years	12	11	5	6	7%
3-5 Years	24	24	26	14	22%
6-10 Years	29	35	37	18	30%
No Answer	29	22	16	52	29%
Total	100%	100%	100%	100%	100%
Owner Participation					
Yes	41	83	86	49	72%
No	59	11	9	8	11%
No Answer	*	7	5	43	17%
Total	100%	100%	100%	100%	100%
Number of Resp.	17	103	145	111	376

One measure of a plan's value is whether the owner participates. If the owner participates, he presumably has no better alternative and the plan is the best available under the circumstances. Seventy (70) percent of owners with an employee retirement plan participated in their employee plan. Eliminate multiemployer plans because the individual small business owner has no practical influence over its content, and the figure rises somewhat. While the very largest and the very smallest were somewhat less likely to experience owner participation, there was little differentiation by firm size.

Plan Choice

The selection of a small business employee retirement plan is heavily influenced by advisors (Table 26). While there are usually multiple reasons for plan selection, the recommendation by an advisor influenced the small business owner decision at least half the time. Those with a defined benefit plan were most likely to cite recommendations from an advisor as their reason for choice, one indication of the more complex nature of defined benefit plans.

A second tier of reasons in frequency of note followed advisor recommendations. Contribution flexibility was cited by 34% overall, but by 44% of those choosing a defined contribution plan. Twenty-nine (29) percent indicated tax advantages were a reason. The third and last reason in the cluster was that plan costs could be anticipated (25%). Again, this response was much more characteristic of those with defined contribution plans.

Further down the list in frequency of mention was most generous employee benefits, lowest administrative cost, most generous owner benefits, and ease and cost of start-up. While noted less frequently than several others, they were important reasons for many small business owners. In fact, the notable part about the distribution of reasons for plan choice was its dispersal. Eight different reasons were cited by more than 15% of respondents having a plan; only one -- a reason inherently having nothing to do with the plan, i.e. recommended by an advisor -- reached higher than 35%. There was usually just one reason cited for selection of a multiemployer plan -- negotiated with a union.

Plan Administration

In a plurality of instances (39%), the small business owner or a designated employee managed the retirement plan on behalf of the beneficiaries (Table 27). Among larger employers the percentage declined somewhat despite the presumably greater internal capacity to absorb those responsibilities. Bank trust departments appeared to substitute. Over all size classes, bank trust departments proved the single most frequent source of retirement plan administration outside the firm (17%).

Investment brokers were named by 12%; they were disproportionately managers of smaller plans. Consultants followed at 11%, and 21% either engaged yet another source or did not respond. Not surprisingly, consultants were most often employed when the plan was of the defined benefit variety. Those with defined contribution plans were somewhat more likely to have used either an investment broker or a bank trust department. Multiemployer plans provided a different pattern in administration. Most used either bank trust departments or some "Other" vehicle.

Satisfaction and Problems

Sixty-five (65) percent of small employers expressed general satisfaction with the employee retirement plan they now have (Table 28). Despite complaints over administrative costs and regulatory changes, it appeared that virtually none intended to drop his plan in the foreseeable future. The caveat to the latter observation was the intent of the comparatively large 21% who failed to respond.

Greatest satisfaction was expressed with the defined contribution type plan (85%). Given that affordability and contribution flexibility were major factors in plan selection, it was not surprising that the plan type offering these advantages received the highest approval. A substantial majority (69%) also expressed satisfaction with their defined benefit plan. But differing from those providing defined contribution plans, a large contingent of those offering defined benefit plans, though not satisfied, couldn't afford a better one (17%). Least satisfacton was found with the multiemployer type and while probably an accurate reflection of the actual situation, the small sample size (n=17) allowed no conclusions.

While there were no mutinous rumblings similar to those which resulted in cancellation of many retirement plans during the mid-1970's, small business owners reported problems with their retirement plans. The most prevalent of these problems was constant governmental changes in the rules and regulations affecting their offerings (Table 29). Nearly two of five (37%) cited the problem as their most important in plan maintenance. Moreover, nearly half who were generally satisfied with their plans pointed to problems created by frequency of regulatory changes.

Regulatory changes generally inflate administrative costs. The two most frequently mentioned problems--regulatory change and administrative costs (15%)--are therefore, related and accounted for 52% of total responses. Other problems, such as "top heavy" restrictions and restrictions on fund usage, were noted considerably less often. The concern over multiemployer withdrawal liability, so strongly expressed by many with multiemployer plans, was not evident in the totals. Just a small percentage have multiemployer plans, although most of those reported their withdrawal liability as problem number one.

Table 26

SMALL BUSINESS OWNER REASONS FOR RETIREMENT PLAN CHOICE BY TYPE OF RETIREMENT PLAN
(in percent)

REASON FOR PLAN CHOICE	TYPE OF PLAN				
	Multi-Employer	Defined Benefit	Defined Contribution	No Answer	Total@
Recommended by Advisor	*	60	52	46	50%
Negotiated with Union	63	3	4	3	6%
Ease and Cost of Start-Up	*	10	19	21	16%
Can Anticipate Costs	5	20	32	22	25%
Most Generous Owner Benefits	5	23	17	7	16%
Tax Advantages	11	27	35	24	29%
Contribution Flexibility	5	21	44	36	34%
Lowest Administrative Cost	4	10	21	16	16%
Most Generous Employee Benefits	16	19	21	9	17%
Chosen Before Present Owner	5	7	3	2	4%
Other	5	3	1	1	2%
Total@	114%	203%	249%	187%	215%
Number of Respondents	17	103	145	111	376

* less than 0.5%
@ respondents could mark more than one answer

Reasons for Instituting a Plan

The most important reasons for instituting employee retirement plans focused on employees themselves (Table 30). Twenty-nine (29) percent cited the need to keep valued employees as their principal motivation. The owners feared competitive pressures created by other employers and instituted a plan to help retain employees. The reason noted with second greatest frequency was that employees needed a plan (24%). A variant of this theme probably is that it was the right thing to do. Together, these employee-directed reasons accounted for 53% of responses, or more than 60% of those providing an answer.

Table 27

SMALL BUSINESS EMPLOYEE RETIREMENT PLAN MANAGER
BY SMALL BUSINESS ANNUAL GROSS RECEIPTS
(in percent)

	ANNUAL GROSS RECEIPTS ($000's)					
RETIREMENT PLAN MANAGER	Under 500	500-1,499	1,500-4,999	5,000 or More	No Answer	Total
You or Someone in Your Business	39	44	41	29	33	39%
Consultant	8	13	11	12	7	11%
Investment Broker	19	10	12	9	13	12%
Bank Trust Department	14	15	14	24	27	17%
Other	4	5	9	9	13	7%
No Answer	16	13	13	16	7	14%
Total	100%	100%	100%	100%	100%	100%
Number of Respondents	74	104	108	75	15	376

Table 28

SMALL BUSINESS OWNER SATISFACTION WITH EMPLOYEE
RETIREMENT PLAN BY TYPE OF RETIREMENT PLAN
(in percent)

	TYPE OF PLAN				
SATISFACTION	Multi-Employer	Defined Benefit	Defined Contribution	No Answer	Total
Generally Satisfied	53	69	85	51	65%
Not Satisfied, Can't Afford Better	2	17	3	4	6%
Not Satisfied, Soon Will Have Better	*	6	3	4	4%
Soon Will Reduce Coverage	*	2	*	*	1%
Soon Will Drop Coverage	*	1	1	2	1%
Subject to Union Agreement	35	1	3	2	2%
No Answer	2	5	6	38	21%
Total	100%	100%	100%	100%	100%
Number of Respondents	17	103	145	111	376

* less than 0.5%

Table 29

MOST IMPORTANT SMALL BUSINESS PROBLEM IN MAINTAINING CURRENT EMPLOYEE RETIREMENT PLAN BY SMALL BUSINESS OWNER SATISFACTION WITH CURRENT EMPLOYEE RETIREMENT PLAN
(in percent)

	SATISFACTION WITH RETIREMENT PLAN			
PROBLEM	Generally Satisfied	Other Views	No Answer	Total
Administrative Costs	19	22	3	15%
Multi-Employer Withdrawal Liability	2	9	*	2%
Constant Government Changes	51	37	4	37%
Restrictions on Fund Use	2	4	3	2%
Top Heavy Restrictions	9	9	*	7%
Other	7	15	*	6%
No Answer	11	19	91	32%
Total	100%	100%	100%	100%
Number of Respondents	245	54	77	376

*Less than 0.5%

Direct personal motives were also often behind institution of a plan, but much less often than employee centered motives. Tax advantages and best way for the owners to establish a personal plan each attracted an 11% response. Outside influences, such as labor bargaining and procuring a business with an established plan, accounted for another 10%. The remainder (13%) offered no reason.

The median number of years these retirement plans have been in existence is about nine. Reviewing the distribution of years in existence on Table 31, it appears clear the relative number of plans is about holding its own over time. There is neither any great rush to institute them nor a trend to eliminate them. However, there do appear to be some changes over time in the reasons for instituting a plan. For example, the need to keep valued employees was cited more frequently by those with newer plans, probably indicating increased labor market pressures. Union negotiated was inversely related to plan age, illustrating the comparatively early union entry into retirement plans. The impact of incentives created by tax advantages presents no real pattern of responses.

Opting Out of Plans

One in ten (10%) respondents reported that they had either cancelled or withdrawn from an employee retirement plan (Table 32). The most frequent reason cited for leaving a retirement plan was changing and complex regulations. Thirty-five (35) percent of those having dropped a plan offered that explanation. Another 8% cited increased administrative costs. These two government-caused reasons accounted for 43% of all small business owners who either have dropped or cancelled a retirement plan (and are still in business).

A second group of almost identical size (42%) offered market-related reasons for their actions. A majority in that group (25% of the total) pointed to lower sales or profitability. Changes in the labor force accounted for another 17%.

Of those small business owners cancelling or withdrawing from a plan, about two of five (39%) now provide a different plan. Firms fitting these conditions tended to fall in the mid-size range of small businesses (Table 33). Unfortunately, there were only 54 cases (N=54). This number is insufficient to cross-tabulate against reasons for dropping and reasons for instituting a retirement plan. However, the subject offers an intriguing possibility for additional inquiry.

Table 30

MOST IMPORTANT SMALL BUSINESS OWNER REASON FOR INSTITUTING EMPLOYEE RETIREMENT PLAN BY ANNUAL GROSS RECEIPTS OF SMALL BUSINESSES
(in percent)

MOST IMPORTANT REASON FOR INSTITUTING PLAN	ANNUAL GROSS RECEIPTS ($000's) Under 500	500-1,499	1,500-2,999	3,000 Or More	No Answer	Total
Needed to Keep Valued Employees	18	31	33	33	27	29%
Employees Needed a Plan	15	24	32	23	47	24%
Union Negotiated	8	3	3	8	7	6%
Tax Advantages	19	9	14	7	13	11%
Chosen Before Present Owner	3	2	6	6	*	4%
Best Way for Owners to Establish Personal Plan	19	14	5	9	*	11%
Other/No Answer	19	13	8	15	*	14%
Total	100%	100%	100%	100%	100%	100%
Number of Respondents	74	104	16	117	15	376

* less than 0.5%

Table 31

MOST IMPORTANT SMALL BUSINESS OWNER REASON FOR INSTITUTING EMPLOYEE RETIREMENT PLAN BY YEARS PLAN IN EXISTENCE
(in percent)

MOST IMPORTANT REASON FOR INSTITUTING PLAN	YEARS PLAN IN EXISTENCE						
	Less than 2	3-5	6-10	11-15	16 and Over	No Answer	Total
Needed to Keep Valued Employees	28	39	35	34	23	16	29%
Employees Needed a Plan	34	27	15	25	36	17	24%
Union Negotiated	3	4	3	4	21	5	6%
Tax Advantages	22	13	12	18	6	3	11%
Chosen Before Present Owner	3	1	6	7	3	*	4%
Best Way for Owners to Establish Personal Plan	3	14	23	10	8	4	11%
Other/No Answer	6	1	7	2	*	*	14%
Total	100%	100%	100%	100%	100%	100%	100%
Number of Respondents	32	77	69	68	53	77	376

Table 32

PERCENT OF SMALL BUSINESS OWNERS HAVING CANCELLED OR WITHDRAWN FROM RETIREMENT PLAN AND OWNER REASON FOR ACTION

ACTION TAKEN	CANCELLED OR WITHDRAWN FROM PLAN	REASON FOR ACTION
Yes	10	
Change in Workforce		17
Lower Sales or Profitability		25
Reduction in Owner Benefits		2
Increased Administrative Costs		8
Changing and Complex Regulations		35
Other		12
Subtotal		100%
No	83	
No Answer	7	
TOTAL	100%	

Table 33

PERCENT OF SMALL BUSINESS OWNERS WHO HAVE CANCELLED OR WITHDRAWN FROM AN EMPLOYEE RETIREMENT PLAN BUT WHO CURRENTLY HAVE ONE BY FIRM SIZE

CANCELLED OR WITHDRAWN FROM PLAN	FIRM SIZE (FULL-TIME EMPLOYEES)							
	1-4	5-9	10-19	20-49	50-99	100+	No Answer	Total
Yes	4	10	20	23	18	11	23	14%
No	91	81	78	73	80	85	62	81%
No Answer	5	10	3	5	2	4	15	5%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Number of Resp.	76	73	81	62	44	27	13	376

Non-Provision

A healthy majority of small businesses (74%) offer their employees no retirement plan. The most frequently cited reason (39%) for this situation was "Can't Afford One" (Table 34). This result was to be expected given a similar experience with the more popular health insurance benefit. But no other response even reached the double digit level. Start-up problems tallied 9%, followed by an employee preference for direct compensation (6%). The remainder of the provided responses drew even less mention. Administrative costs amounted to an asterisk, probably indicating that many are unfamiliar with problems occurring once a plan has been established.

A whopping 33% failed to answer the question. Unfortunately, there is no obvious reason why that action was taken by so many. Perhaps there were more important reasons, e.g., not commonly given in businesses like mine, which were not presented to respondents. Perhaps the positioning of the question on the page caused respondents to miss it. One could even speculate that an employee retirement benefit is not considered normal or usual (which is accurate in smaller firms), therefore no conscious reason is available for its non-provision. But there is no way of knowing which, if any, of these possibilities is accurate.

A variety of incentives or causes to provide an employee retirement plan were considered important by small firms. However, with the exception of "Business Becomes More Profitable" which was cited by 38%, no single reason was cited by as many as one in four (Table 34). A corollary to the business becoming more profitable rationale, and the second most frequently cited reason, was "Tax Advantages Increased" (20%). For a tax advantage to be useful, however, there must be something to tax. As a result, direct provision of tax code incentives to create or

expand retirement plans will be useful to some, i.e. those responding to tax advantages increased, but will leave many unaffected, i.e. those responding to business becomes more profitable. The dilemma created by the differential tax situations of varying businesses is certainly not unknown, but remains no less difficult. This is particularly true when so many with plans (those who have already acted) attributed their behavior to tax advantages (see Reasons for Instituting a Plan and Table 31).

Twelve (12) percent asserted a cause to provide a retirement plan would be the ability to reinvest plan assets into the business. Suggestions have been made to relax rules disallowing such treatment of capital. But it appears inconsistent that over twice as many reported investment ability a cause to establish a retirement plan as (Table 29)

Table 34

SMALL BUSINESS OWNER REASONS EMPLOYEE RETIREMENT PLAN NOT PROVIDED ALL FULL-TIME EMPLOYEES BY FIRM SIZE
(in percent)

	FIRM SIZE (FULL-TIME EMPLOYEES)							
REASON NOT PROVIDED	1-4	5-9	10-19	20-49	50-99	100+	No Answer	Total
Can't Afford One	50	37	29	33	22	18	28	39%
Start-Up Costs, Red Tape, Etc.	8	9	13	15	7	*	3	9%
Employees Prefer Compensation	6	6	8	4	11	6	5	6%
Too Much Employee Turnover	5	3	6	1	4	*	2	4%
Administrative Costs	*	*	1	*	*	6	*	*
Capital Needed to Reinvest in the Business	5	5	7	3	7	6	5	5%
Changing and Complex Regulations	*	1	2	3	*	6	*	1%
Insufficient Owner Benefits	3	6	3	4	*	*	2	3%
No Answer	23	33	31	37	48	59	54	33%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Number of Resp.	484	252	150	100	27	17	146	1176

* less than 0.5%

reported the lack of reinvestment ability a cause for not instituting a plan in the first place (Table 35).

Nine (9) percent, or 8% of the total population, indicated they would not provide such an employee benefit under almost any circumstance. That represents four times the number responding in a similar manner to the provision of employee health insurance.

Information Sources

Accountants were most frequently cited by small business owners as the single most important source of information on pensions, options available for retirement income, etc. (Table 36). Twenty-six (26) percent named accountants, with insurance agents (18%) and financial planners (11%) following. Trade associations, magazines/publications, business consultants, bankers, and lawyers were infrequently mentioned as the most important source of information on retirement financial planning. Twenty-two (22) percent did not respond. However, examination of Table 35 shows that non-response was, located by several orders of magnitude, disproportionately among those who had no retirement plan. This distribution implies that many small business owners don't have a most important source simply because they don't pay much attention to the matter. This is not an isolated phenomenon. A disproportionately large group not providing health insurance also failed to identify a most important information source for health-related matters (see Table 26).

Those small business owners not providing an employee retirement plan were as likely to cite accountants and insurance agents as their most important source of information as were those providing plans. Virtually all other potential sources of information were noted with much greater frequency by the latter group. This differential was particularly notable among financial planners and business consultants.

Those with retirement plans covering all full-time employees were much less likely to cite accountants than were those who had just a portion. The reverse was true of financial planners. Arguably, the larger the retirement plan (in terms of coverage), the greater the shift to more specialized sources of information.

Concluding Observations

Employer provided employee retirement programs are not common in small businesses. Formal plans appear even less common. But the precise extent of benefit provision is difficult to determine. The principal interpretational problem comes with profit-sharing benefits. Survey responses indicated that profit sharing doesn't fit any prearranged benefit classification scheme very well. Many small business owners considered it a "free-standing" benefit which may or may not eventually become an employer provided retirement program. Evidence supporting this

Table 35

CAUSES FOR SMALL BUSINESS OWNERS TO PROVIDE
EMPLOYEE RETIREMENT PLAN BY FIRM SIZE
(in percent)

CAUSE TO PROVIDE	FIRM SIZE (FULL-TIME EMPLOYEES)							
	1-4	5-9	10-19	20-49	50-99	100+	No Answer	Total@
Business Becomes More Profitable	45	40	34	37	15	12	24	38%
Comparative Costs, Options Clearer	11	13	13	14	7	*	3	10%
Employees Asked for One	11	10	13	9	15	*	3	10%
Administrative Costs Could Be Cut	8	8	13	8	*	*	2	2%
Tax Advantages Increased	24	22	21	23	15	6	5	20%
Good Employees More Difficult to Attract	8	7	4	6	7	*	1	6%
Plan Assets Could Be Reinvested in the Business	12	12	16	14	7	6	7	12%
Wouldn't Provide Under Almost Any Condition	9	9	9	7	7	12	11	9%
Total @	128%	121%	123%	118%	73%	36%	56%	109%
Number of Resp.	484	252	150	100	27	17	146	1176

* less than 0.5%
@ respondents could mark more than one answer

observation lies in the relatively large number of respondents checking profit sharing while also indicating they either did not have a retirement plan or the plan was other than a defined contribution plan.

Employee retirement benefits are provided in a minority of small businesses. Given the hierarchy of benefit introduction noted earlier, retirement benefits among the nation's small businesses will probably increase incrementally over time. But there appears to be means to accelerate or retard the speed of change. The experience of the mid-70's with its policy emphasis on rigidity and uniformity was an example of how to retard it. Flexibility and uniqueness, both in terms of regulatory

policy and marketing as continually underscored in this survey, are the means to accelerate it. While provision of retirement benefits is not the only important possible effect of the trade-off between the two regulatory poles, it is one that should never be forgotten.

Table 36

MOST IMPORTANT SOURCE OF EMPLOYEE RETIREMENT PLAN INFORMATION FOR SMALL BUSINESS OWNERS BY PERCENT OF FULL-TIME EMPLOYEES IN EACH FIRM

MOST IMPORTANT INFORMATION SOURCE	PERCENT OF FULL-TIME EMPLOYEES COVERED IN EACH FIRM					
	None+	1-39%	40-60%	61-99%	100%	Total
Accountant	26	30	32	30	21	26%
Insurance Agent	18	22	18	13	17	18%
Trade Association	6	8	18	13	10	8%
Financial Planner	7	19	18	19	24	11%
Magazines/Publications	7	5	*	4	4	6%
Business Consultant	2	5	*	9	7	4%
Lawyer	1	3	9	4	4	2%
Banker	2	3	5	*	4	2%
Other	1	3	*	4	2	2%
No Answer	29	3	*	6	6	22%
Total	100%	100%	100%	100%	100%	100%
Number of Resp.	1063	37	22	54	263	1439

+ includes non-respondents.
* less than 0.5%

SURVEY SAMPLE

The preceding report was based on data gathered from a mail survey of small business owners conducted in September, 1985. The survey sample was randomly drawn from the membership file of the National Federation of Independent Business (NFIB). All regular members in the file were eligible for selection, the exception being a comparatively small percentage who had no full-time employees. Thus, the resulting sample consisted entirely of small employers. Each of the 7,750 small business owners in the sample received a questionnaire (a copy provided in Questionnaire, p. 46) and a follow-up two weeks later. There were 1,439 usable responses for a 19% response rate, 11 percentage points less than NFIB normally experiences in such surveys.

There is little a priori reason to fear a sample bias. Dunkelberg and Scott have demonstrated that the NFIB membership file reasonably reflects the universe as the universe can best be estimated.*/ Moreover, the sample was not contaminated by association activities involving extensive sale or promotion of employee benefit packages. And while response rates of 30%, let alone 19%, never can provide a survey analyst comfort, previous experience in comparing NFIB-collected responses to equivalent data collected by other organizations shows remarkable consistency, particularly within size class. The differences that do exist usually involve "levels" for the entire population resulting from the somewhat larger businesses within the NFIB file.

Tables A and B provide comparisons of the estimated universe, the survey sample, and the survey respondents. (The estimated universe measures were drawn from the Small Business Administration's (SBA) Small Business Data Base as published in the annual The State of Small Business Report.) Note on Table A that the industry-by-industry differences in these data sets are minimal. Survey respondents are somewhat overrepresented among manufacturers and underrepresented among services. In the other major industries, however, differences usually involve only a percentage point or two.

When employee size is substituted for industry in the three set comparison (Table B), the result is not as satisfactory. The profile of survey respondents and the survey sample are virtually identical, with the exception of 1-4 employee class size and "no answer." Distributing the no answers proportionally among all size classes creates a survey respondent profile still somewhat underrepresented in the 1-4 employee class and a percentage point or two overrepresented in the others. That distribution in and of itself should be sufficient to cover all concerns over the response rate. However, the responses of "no answers" and the

*/William C. Dunkelberg and Jonathan A. Scott, Report on the Representativeness of the National Federation of Independent Business Sample of Small Firms in the United States, Small Business Administration, 1984.

responses of other size classes to other comparable questions produce an uncommon similarity between the "no answers" and the 1-4 employee size class. Given that similarity and previous experience which indicates the smallest are most likely not to respond to size questions, responses proportionally allocating "no answers" probably do not assign enough to the smallest size class. As a result, the profile of survey respondents and the survey sample is probably even better than the considerable similarity previously shown.

Table A

COMPARISON OF ESTIMATED UNIVERSE, SURVEY SAMPLE, AND SURVEY RESPONSES BY INDUSTRY (in percent)

INDUSTRY	ESTIMATED UNIVERSE	SURVEY SAMPLE	SURVEY RESPONDENTS
Construction	14	11	12
Manufacturing (includes Mining)	9	13	13
Transportation	4	3	4
Wholesale	10	7	10
Retail	29	27	27
Agriculture	4	5	5
Financial Services	8	7	9
Services	24	24	19
No Answer	--	2	1
Total	100%	100%	100%

While the estimated universe inflates the 1-4 employee size class a percentage point or two by inclusion of some non-employers, there remains a difference between the estimated universe and the sample. Sample small business owners (as well as respondents) have somewhat larger businesses on balance. The estimated universe contains approximately 10 percentage points more firms in the 1-4 employee size class than did the sample on the response. Those 10 percentage points were distributed over other size classes. Thus, population "levels" are unduly influenced, though not greatly, by owners of firms larger than 1-4 employees.

Table B

COMPARISON OF ESTIMATED UNIVERSE, SURVEY SAMPLE, AND SURVEY RESPONSES BY EMPLOYEE SIZE
(in percent)

EMPLOYEE SIZE	ESTIMATED UNIVERSE	SURVEY SAMPLE	SURVEY RESPONDENTS
1-4	57	48	37
5-9	21	21	21
10-19	11	15	15
20-49	7	11	10
50-99	2	3	4
100 or more	2	2	3
No answer	--	1	11
Total	100%	100%	100%

NFIB EMPLOYEE BENEFITS SURVEY

(Please mark appropriate answers or fill in the blanks)

1. What is the legal form of your business?
   [1] Proprietorship [2] Partnership [3] Corporation [4] Sub-chapter S Corp. 1

2. Please classify your **major** business activity, using one of the categories of examples below. (If more than one applies, mark the one which contributes the most toward your gross sales or total revenues.)
   [1] Construction (general contractor, painting , carpentry, plumbing, heating, electrical, highway, etc.)
   [2] Manufacturing and mining (including dairy processor, printer, publisher, etc.)
   [3] Transportation, travel agency, communication, public utilities (truckers, movers, broadcasters, etc.)
   [4] Wholesale (including grain elevator, livestock dealer, distributor of equipment, manufacturer's rep., etc.)
   [5] Retail (including service station, restaurant, bar, radio and TV store, drug store, florist, apparel, etc.) 2
   [6] Agriculture, veterinarian, forestry, landscaping, fisheries, etc.
   [7] Financial, insurance, real estate, bank, savings & loan, etc.
   [8] Beauty salon, barber shop, garage, motel, hotel, repair service, bookkeeping service, photographer, funeral director, rental agency, credit bureau, laundry, etc.
   [9] Physician, dentist, attorney, engineer, architect, accountant, skilled nursing care facility, etc.
   [10] Other (please describe) _____

3. During the last calendar or fiscal year, what were your gross sales or receipts?
   [1] Under $100,000 [4] $500,000-799,999 [7] $3,000,000-4,999,999
   [2] $100,000-199,999 [5] $800,000-1,499,999 [8] $5,000,000-9,999,999 3
   [3] $200,000-499,999 [6] $1,500,000-2,999,999 [9] $10,000,000 or more

4. How many people do you employ, **not including the owner(s)**? (A part-time employee is generally thought of as working less than 35 hours per week.)
   a) Full-time (Total) _____ 4-6
      Teenagers _____ 7-8
      65-69 years old _____ 9-10
      70 years old or more _____ 11-12
   b) Part-time (Total) _____ 13-15
      Teenagers _____ 16-17
      65-69 years old _____ 18-19
      70 years old or more _____ 20-21

5. What type of fringe benefits do you provide full time employees who have been on the job past any probationary period you have? (Mark appropriate answers)

Benefit	1 Not Provided Employees (0%)	2 Provided Some Employees (1-39%)	3 Provided About Half Employees (40-60%)	4 Provided Most Employees (61-99%)	5 Provided All Employees (100%)	
a) Health Insurance						22
b) Dental Insurance						23
c) Retirement Plan (including a Profit Sharing or Capital Accumulation Plan)						24
d) Paid Vacations						25
e) Paid Sick Leave						26
f) Long-Term Disability Insurance (not Workers Comp)						27
g) Life Insurance						28
h) Education Assistance						29
i) Employee Discounts						30
j) Employee(s) set own working hours (flex time)						31
k) Paid Lunch Break						32
l) Dependent Care						33
m) Legal Assistance						34
n) Other (specify): _____						35

6. Please estimate your firm's average monthly payroll. (Do **not** include voluntary fringe benefit costs, FICA, FUTA, etc.)
   $ _____ per month 36-39

7. Please estimate your firm's average monthly contribution for all **voluntary** fringe benefits. (Do **not** include FICA, FUTA, Workers Comp, etc.)
   $ _____ per month 40-43

8. Please estimate your firm's average monthly contribution for **compulsory** fringe benefits, e.g. FICA, FUTA, Workers Comp. (Do **not** include employee withholdings.)
   $ _____ per month 44-47

HEALTH INSURANCE

9. In the past twelve (12) months, how many hours have you and/or an employee(s) on your behalf spent investigating health insurance options, controlling health care costs, etc.?
[1] Less than 1 hour
[2] 1-4 hours
[3] 5-8 hours
[4] 9-16 hours
[5] 17-24 hours
[6] 25-40 hours
[7] 41-80 hours
[8] 81 hours or more
48

10. What is your **most important** source of information on health insurance, control of health care costs, health insurance benefits, etc. (Check **one** only)
[1] Local insurance agent
[2] Insurance broker
[3] Trade, business, professional association
[4] Health care providers, e.g., doctors, nurses, etc.
[5] Magazines, publications, etc.
[6] Business consultant
[7] Other (specify): _____
49

11. Does your State require any minimum health insurance coverages, e.g. any policy must include alcohol or drug rehabilitation coverage, outpatient mental health?
[1] Yes
[2] No
[3] Don't know
50

11a. If "yes", how has your firm responded to "minimum coverage" requirements (Mark **one** only)
[1] No change, already had "minimum coverage"
[2] Expanded coverage to achieve "minimum coverage"
[3] Shifted coverage; increased in some areas, reduced in others
[4] Dropped all coverage
[5] No employee health insurance, so doesn't affect me
[6] Not yet applicable; Don't know
51

If you provide employee health insurance for **all** full-time employees, please move to question #13. If not, please continue.

12. If your firm does **not** provide health insurance for **all** full-time employees, why doesn't it? (Check **all** that apply)
[1] Premiums too high
[2] Employee turn-over too great
[3] Employees generally covered under a spouse or parent's policy
[4] Never thought about it
[5] Administrative expenses too high
[6] Employees prefer compensation in cash/Lack of employee interest
[7] Firm insufficiently profitable
[8] Can't qualify for a group policy
[9] Other (specify): _____
52
53
54
55
56
57
58
59
60

12a. If you can't qualify for a group policy, why not?
[1] Not enough employees
[2] My type of business normally can't get coverage
[3] Never really explained to me
[4] Other (specify): _____
61

12b. What would cause you to purchase group health insurance for your full-time employees? (Mark **all** that apply)
[1] If we could qualify as a group
[2] If the business became more profitable
[3] If insurance rates were lower
[4] If minimum coverage requirements were dropped
[5] If insurance rates and coverages were more stable
[6] If the business got bigger
[7] If it became more difficult to find good employees
[8] If employees asked for it
[9] Would not provide under almost any circumstance
[10] Other (specify): _____
62
63
64
65
66
67
68
69
70
71

If you don't provide employee health insurance, please go to question #19. If you have employee health insurance, please continue. If more than one plan, please refer to the plan covering **most** employees.

13. If health insurance coverage is available to **at least some** of your full-time employees, what basic coverage do you have?
[1] Hospitalization/surgical only
[2] Major medical only
[3] Hospitalization/surgical and major medical
[4] Don't know
72

13a. Approximately what portion of the group health insurance premium do your **employees** pay? (Do not include administrative costs)
[1] None
[2] 1-24%
[3] 25-49%
[4] 50-74%
[5] 75-99%
[6] 100%
[7] Don't know
73

13b. Do your full-time employees have the option of covering a spouse and/or dependents under your firm's group health insurance plan?
[1] Yes
[2] No
74

13c. If your firm provides group health insurance for some, but not all, of your full-time employees (past some probationary period, if applicable), what is the basis for providing coverage? (Mark **all** that apply)

[1] Years on the job 75
[2] A certain wage or salary level 76
[3] Age 77
[4] Level of responsibility (e.g., only supervisors, foremen, etc.) 78
[5] Other (specify): 79

13d. Do your part-time employees generally have the same type of health insurance coverage as your full-time employees?

[1] Have no part-time employees
[2] No, no health coverage for part-time employees
[3] No, some health coverage, but less than for full-time employees 80
[4] Yes, generally the same as for full-time employees

14. Over the past three years, how has your employee health insurance coverage changed? (Mark appropriate places)

[ ] Not in business three years ago 81
[ ] No health insurance three years ago

Coverage	Health Insurance Changes			
a) Percent of Employees	1. No Change	2. Greater	3. Smaller	82
b) Benefits	1. No Change	2. Increased	3. Decreased	83
c) Premium Cost (your cost)	1. No Change	2. Increased	3. Decreased	84
d. Premium Cost (employee's cost)	1. No Change	2. Increased	3. Decreased	85
e) Deductibles	1. No Change	2. Higher	3. Lower	86
f) Co-Insurance Requirements	1. No Change	2. Increased	3. Decreased	87

15. Are you satisfied with the health insurance plan now made available to your employees?

[1] Generally satisfied
[2] Not satisfied, but can't afford a better plan
[3] No, but will have better plan in the near future
[4] Will reduce coverage in near future
[5] Will drop coverage in near future 88
[6] Subject to union agreement

15a. Who put together your group health insurance plan?

[1] Firm qualifies as a group
[2] Business, trade, or professional association
[3] Self-insured 89
[4] Other (specify):

15b. Who is the actual carrier of your group health insurance?

[1] HMO
[2] Self-insured
[3] Blue Cross/Blue Shield 90
[4] Other private carrier (specify):

16. How many employees (full- and part-time) are covered by your health insurance program?

employees 91-93

17. What is your firm's total monthly health insurance premium for this plan?

$ per month 94-97

18. What is your firm's share of the average monthly premium for **individual** employee coverage?

[1] $0-9
[2] $10-24
[3] $25-49
[4] $50-74
[5] $75-99
[6] $100-124
[7] $125-149
[8] $150 or more 98

18a. What is your firm's share of the average monthly premium for an employee with **family** or **dependent** coverage?

[1] $0-24
[2] $25-49
[3] $50-74
[4] $75-99
[5] $100-124
[6] $125-174
[7] $175-224
[8] $225 or more 99

RETIREMENT PLANS

If your firm has a retirement plan, please move to question #20. If not, please continue.

19. If your firm does **not** provide a retirement, pension or capital accumulation plan for at least some full-time employees, why doesn't it? (Mark **one** answer only)

[1] Can't afford one/not sufficiently profitable
[2] Too much cost, red tape, and hassle to start one
[3] Employees prefer benefits in cash/No employee interest
[4] Too much employee turn-over
[5] Administrative costs to keep one are prohibitive
[6] Takes capital needed to reinvest in the business
[7] Changing and complex regulations
[8] Insufficient benefits to owner(s) 100

19a. What might cause you to provide a pension plan for at least some of your employees? (Check **all** that apply)

[1] If the business became more profitable 101
[2] If the comparative costs, options, etc. were more clear 102
[3] If employees asked for one 103
[4] If plan administrative expenses could be cut 104
[5] If tax advantages were increased 105
[6] If good employees became more difficult to attract 106
[7] If plan assets could be reinvested in the business 107
[8] Wouldn't provide under almost any condition 108
[9] Other (specify):

20. Have you ever provided a pension plan **and** either cancelled it or withdrawn from it?
[1] Yes [2] No 109

20a. If "yes", what was the most important reason? (Mark **one** only)
[1] Change in the workforce
[2] Lower sales or profitability
[3] Reduction in owner benefits
[4] Increased administration costs
[5] Constantly changing and complex regulations and paperwork
[6] Other (specify): _____ 110

21. What is your **most important** source of information on pensions, options available for retirement income, financial planning, etc.? (Mark **one** answer only)
[1] Accountant
[2] Insurance agent
[3] Trade, business, professional association
[4] Financial planner/investment advisory firm
[5] Magazines, publications, etc.
[6] Business Consultant
[7] Lawyer
[8] Banker
[9] Other (specify): _____ 1

If your firm has **no** retirement plan, you are finished. Thank you very much. If your firm has a plan, please continue. If your firm has **more** than one plan, please answer the following referring to the plan covering the most employees.

22. If your firm has a pension plan for at least some full-time employees, which basic type is it?
[1] Defined benefit plan (the employee benefit is specified)
[2] Multi-employer plan, e.g. most union plans
[3] Defined contribution plan (the employer contribution is specified) 2

22a. If it is a **defined contribution** plan, which **best** describes the plan? (Mark **one** only)
[1] Profit sharing plan
[2] Money purchase plan (fixed contributions regardless of profitability)
[3] 401(k) plan — employees have choice of cash or tax deferred compensation
[4] SEP (simplified employee pension plans) — contributions to an employee's IRA
[5] Thrift plan — employer contribution dependent on employee contribution
[6] Keogh plan
[7] Employee Stock Ownership Plan (ESOP)
[8] Other (specify): _____ 3

23. Why did you choose the type of retirement plan you did? (Mark **all** that apply)
[1] Recommended by advisor as most appropriate for my business 4
[2] Negotiated with a union 5
[3] Ease and cost of start-up 6
[4] Can anticipate (plan) costs 7
[5] Provides most generous benefits to owners 8
[6] Tax advantages 9
[7] Flexibility of contributions 10
[8] Lowest administrative expense 11
[9] Provides most generous benefits to employees 12
[10] Chosen before I got here or had any "say" 13
[11] Other (specify): _____ 14

24. Why did you institute a pension plan in the first place? (Mark **one** only)
[1] Needed to keep valued employees
[2] Employees needed retirement plans
[3] Union negotiated
[4] Tax advantages
[5] Done before I got here or had any "say"
[6] Best way for owners to establish personal plan
[7] Other (specify): _____ 15

25. What are the basic qualifications for participating in your pension plan? (Mark the **best** answer for each qualification)

a) Employee Type	[1] All full-time	[2] Salaried only	[3] Hourly only			16
b) Employee Service	[1] No requirement	[2] Less than 1 year	[3] 1 year	[4] 2 years		17
	[5] 3 years or more					
c) Vesting Period	[1] No requirement	[2] 1-2 years	[3] 3-5 years	[4] 6-10 years		18

26. Is the owner(s) included in this plan?
[1] Yes [2] No 19

27. How many years has the plan been in existence?
_____ years 20-21

28. Who manages your retirement plan?
[1] You or someone in the business
[2] Consultant
[3] Investment broker
[4] Bank trust department
[5] Other (specify): _____ 22

28a. Please estimate the administrative expenses incurred over the last 12 months to maintain (or start or modify if applicable) your retirement plan.

$_____ 23-26

29. How much did you contribute to the funding last year?

$_____$ 27-30

30. How many employees are... participating in the plan? _____ 31-33
fully vested in the plan? _____ 34-36
partially vested in the plan? _____ 37-39

31. Are you satisfied with the retirement program now made available to your employees? (Mark the **one** best answer.)
[1] Generally satisfied
[2] Not satisfied, but can't afford a better plan
[3] No, but will have a better plan in the near future
[4] Will reduce benefits in the near future
[5] Will soon terminate plan
[6] Subject to union agreement
40

32. What is your single most important problem in maintaining your current retirement plan (Mark **one** only)
[1] Administrative costs (paperwork, accounting, legal fees)
[2] Multi-employer withdrawal liability
[3] Constant government changes requiring plan amendments
[4] Restriction on use of pension funds
[5] Top-heavy restrictions on small business owners
[6] Other (specify): _____
41

THANK YOU

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Senator PRYOR. Ms. Crooks, we look forward to your statement.

STATEMENT OF LOUISE D. CROOKS, PRESIDENT-ELECT, AMERICAN ASSOCIATION OF RETIRED PERSONS, WEST LAFAYETTE, IN, ACCOMPANIED BY DAVID CERTNER, MEMBER OF THE AARP LEGISLATIVE STAFF

Mrs. CROOKS. Thank you, Senator.

I am president-elect of the American Association of Retired Persons, which represents the interests of 27 million older Americans. With me is David Certner, a member of the AARP legislative staff. We are pleased to testify today on S. 1426, the Small Business Retirement and Benefit Extension Act.

AARP commends the subcommittee for recognizing a major gap in private pension coverage today, the small business sector. We agree with the goal of S. 1426 to expand private pension coverage among small businesses.

AARP firmly believes, however, that repeal of the "top-heavy" pension rules will do little to promote the establishment of new plans. At the same time, it will undermine the adequacy of small pension plans for lower-paid employees, especially low-income women.

Ninety percent of employees of medium and large companies are covered by private pensions. Only 25 percent of small businesses offer pensions. Today, when most new jobs are being created by small business, the lack of small employer pension plan sponsorship remains a real threat to future retirees.

To enhance equity in some small plans, top-heavy rules were enacted as part of TEFRA. These rules ensure that pension plans paying large benefits to highly compensated employees also provide some benefits to lower-paid employees.

A congressional research service report found that the TEFRA top-heavy rules benefit shorter-term workers, especially women, whose average job tenure is only 3.3 years. It also found that all lower-paid workers with job tenures of 5 to 10 years would do better under the minimum-benefit provisions.

Recent pension equity legislation has sought to ensure that the over $50 billion in tax subsidies for pension plans provides adequate retirement security to employees. The top-heavy rules are consistent with this approach, and in fact increase pension equity.

AARP finds the case for repealing the top-heavy rules unpersuasive. All businesses have already been required by TEFRA to amend their plans; also, only those new plans that provide substantial benefits to key employees would have to provide faster vesting and minimum benefits.

Second, AARP believes that the top-heavy rules are consistent with the underlying principles behind 5-year vesting and the new integration rules of the Tax Reform Act. Both seek increased vesting for those unlikely to invest, and increased benefits for those who might not receive them.

In short, AARP opposes repeal of the top-heavy rules and believes that alternative rules or model plans should be considered first.

In addition, small business owners need to receive more information on private pension options. While education alone cannot solve the problem, adequate information is a basis on which decisions can be made.

S. 1426 also proposes a tax credit for small business pension plans. A tax credit may not be the most practical approach and may be an inefficient subsidy. If a credit can be shown to be effective, AARP is willing to support such efforts at pension expansion.

We, again, commend this committee for addressing the problem of plan coverage in small businesses. The proposed tax credits, along with small business educational efforts, are among the approaches that should be explored in depth.

We look forward to working with the committee and Congress in developing effective ways to promote pension plan expansion, in meeting the needs of plan sponsors and plan participants, and in ensuring that tax subsidies for pension plans provide adequate benefits for future retirees at all wage levels.

Thank you.

Senator PRYOR. Thank you very much, Ms. Crooks.

[Mrs. Crooks' prepared statement follows:]

STATEMENT

OF THE

AMERICAN ASSOCIATION OF RETIRED PERSONS

The American Association of Retired Persons (AARP), representing the interests of 27 million persons age 50 and above, is pleased to testify on S. 1426, the Small Business Retirement and Extension Act. AARP is particularly concerned with measures in this bill designed to address the inadequacy of pension coverage in small business.

The Association commends this subcommittee for recognizing one of the major gaps in private pension coverage today -- the small business sector--and agrees with the goal of S. 1426 to expand private pension coverage among small businesses. AARP firmly believes, however, that repeal of the "top-heavy" pension rules will do little to promote the establishment of new plans, while at the same time, it will severely undermine the adequacy of small pension plans for lower paid employees and other employees who are less likely to be covered.

I. BACKGROUND

AARP has long supported expanding the pension system to make it a more available source of retirement income. While Social Security supplies a floor of retirement income, the private pension system, as well as personal savings, and post-retirement employment for some, must supplement Social Security in order to provide a more complete retirement income package.

The private pension system has made great strides over the years towards meeting its goal of becoming a reliable source of retirement income. Despite these advances, a number of deficiencies remain. Today, only about one-half of all employees

are covered by a private pension plan; of this number, only about half ever receive a pension benefit.

The Tax Reform Act expanded coverage requirements in existing and new plans, but did not provide significant new incentives for those employers who do not now sponsor pension plans. While nine out of ten employees of medium and large companies are covered by some type of private pension plan, the small business sector of our economy has lagged behind in pension sponsorship. Studies indicate that pensions are offered by only about 25 percent of small businesses employing fewer than 25 workers. It has been projected that if firms employing fewer than 100 workers were as likely to offer pension plans as firms employing up to 500 workers, 7.6 million more employees would be covered. In an economy where most of the new jobs are being created by small business, the lack of small employer pension plan sponsorship remains a real concern for the retirement security of future retirees.

To further understand the needs of small business, AARP contracted with the Opinion Research Center (ORC) to conduct a focus group study to determine why small businesses do or do not choose to provide pension plans. One finding of the study was that many small business owners did not know about the variety of retirement plans available. Those who provided plans had much higher awareness levels than those who did not. There was a general lack of understanding of the differences among various types of plans. In addition, those not offering pensions had an exaggerated view of the administrative complexity and regulatory burdens related to pension plans. Focus group participants recommended that more education about retirement plans for small business be provided as one way to encourage pension growth.

As an outgrowth of this study, AARP is developing a series of brochures with the cooperation of representatives of the small business community to provide information regarding various pension plan options. AARP has also contributed to the development of a brochure discussing Simplified Employee Plans (SEPs), and AARP welcomes the role of the Department of Labor and the Small Business Administration in the development and distribution of information on this kind of plan option to the small business sector.

Not only should public policy encourage the establishment of private pension plans, but it must also ensure that these plans are adequate and fair, both to the plan sponsor and the rank and file employee. Pension plans that meet the promise of retirement security for only a few fail to fulfill the proper role of the private pension system. The pension system, which operates with a tax subsidy of over 50 billion dollars per year, must do more than benefit a select few.

II. "TOP-HEAVY" RULES

The "top-heavy" rules were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Prior to their enactment, serious problems existed with some tax subsidized plans that provided benefits to only a few highly paid employees. This pattern was particularly apparent in many small businesses, especially professional corporations, where only key employees ever received benefits. These rules were designed to ensure that pension plans that provided large pension benefits to highly paid employees also provided some benefits to lower paid employees. Since TEFRA, several other tax and pension changes have been made to ensure that pension and welfare benefit plans are nondiscriminatory, a public policy which AARP strongly supports.

A plan is defined as "top-heavy" if more than 60 percent of the accrued benefits (or contributions) are provided to key employees. A "key employee" is defined as an officer (receiving more than a specified dollar amount), a 5 percent owner, a 1 percent owner with compensation in excess of $150,000, or the employees owning the 10 largest interests in the firm (receiving more than a specified dollar amount).

While these rules are not specifically applicable only to small business, the practical effect is that the smaller the plan, the more likely it may be top-heavy. This is simply a result of the arithmetic of plan design; the fewer the number of employees, the more likely it is that the greater percentage of pension benefits will go to key employees.

If a plan is determined to be top-heavy, certain special rules apply in order to ensure that lower-paid, non-key employees receive their share of the tax-subsidized retirement fund. Specifically, a top heavy plan must provide the following:

1. **A Faster Vesting Schedule:** 100% vesting after 3 years (or 6 year graded vesting, beginning with 20% vesting after 2 years).

2. **A Minimum Benefit/Contribution:** The minimum benefit for lower paid workers in a defined benefit plan is 2% of pay times the number of years of service, to a maximum of 20%. The minimum contribution for lower paid workers in a defined contribution plan is 3% of compensation; if the percentage for key employees is less than 3%, then the lower percentage is the minimum contribution.

3. **A Limit on Compensation:** Only $200,000 of a participant's compensation can be taken into account under the plan.

4. **A Combined Plan Limit:** If the employer sponsors both a defined benefit and a defined contribution plan, then limitations are placed on the amount of benefits and/or contributions.

III. WHO BENEFITS FROM THE TOP-HEAVY RULES

The TEFRA top-heavy rules are particularly beneficial to shorter term workers, especially women. According to a recent Bureau of Labor Statistics report, the average job tenure for men is 5.1 years, while for women it is only 3.3 years. These numbers are even more dramatic in the small business sector, where only 25 percent of employees remain with their company for three years. While 5 year vesting (enacted as part of the Tax Reform Act of 1986) goes a long way towards meeting the needs of today's mobile workforce, the reality is that for most small business employees, particularly women, 5 year vesting does not meet their needs.

A recent Congressional Research Service (CRS) report found that the top-heavy rules are especially beneficial for women. Because pensions have characteristically rewarded long-term uninterrupted work histories and are frequently linked to earnings, women have often found that they have no or very inadequate private pensions. As a result of their lower earnings, shorter job tenure, and their larger relative representation among rank-and-file workers, women appear to be the chief beneficiaries of the top-heavy rules. The CRS report also found that all lower paid workers with short job tenures of 5 or 10 years would do better under the minimum benefit provision of the top heavy rules. At age 65, the average female with 20 years service would also have a higher pension benefit under the top-heavy rules. Thus, for example, women in their forties entering or returning to the labor force would be especially benefited by the top-heavy rules.

The fact that lower paid short-term employees--particularly women--do not receive adequate pension benefits is still a problem of today's pension system, despite the recent tax

changes. The thrust of pension equity legislation over the past several years has been to ensure that the large tax subsidy given to employers to set up and maintain pension plans delivers adequate retirement security to employees at all wage levels. The intent of the top-heavy rules is entirely consistent with this approach, and in fact, furthers pension equity. Repeal of these rules would be a step back from retirement security for future retirees.

Of particular concern is the high poverty rates for current older women and older minorities and their dependency on Social Security for retirement income. One way to help combat poverty in the future is to ensure greater access during their working lives to the private pension system in order to help secure a more adequate retirement income.

IV. ARGUMENTS AGAINST TOP-HEAVY RULES

Proponents of repeal of the top-heavy rules suggest that recent pension changes in the Tax Reform Act remove the need for the top-heavy requirements. They also complain of the burden of the rules for small companies. AARP finds these arguments unpersuasive, especially in light of the concession by these proponents that the top-heavy rules benefit low-income workers.

First, all businesses have already been required by TEFRA to amend their plans to conform with the top-heavy rules. No further amendment is currently required. In fact, a report prepared by the National Federation of Independent Businesses (NFIB) stated that only 7 percent of small employers with plans cited the top-heavy rules as a problem. In addition, only those new plans that provide a benefit structure in which 60 percent of the benefits go to the higher paid key employees are required to provide faster vesting and a minimum benefit. While a "carrot"

in the form of substantial tax subsidies may be deemed necessary to encourage small employers to set up pension plans, lower paid employees should be entitled to their share of the "carrot." If small business plans provide substantial benefits to higher income employees, then a mechanism which provides benefits to lower income employees is essential.

Second, proponents of repeal of the top-heavy rules argue that 5 year vesting, plus the new integration rules, make the top-heavy rules obsolete. AARP strongly supported these Tax Reform Act changes, and studies indicate these pension reforms will increase both the number of pension recipients and the average pension amounts over the next 20-30 years. AARP believes that the top-heavy rules are entirely consistent with the underlying principles behind these changes. Far from making top-heavy rules obsolete, the tax reform changes complement the existing top-heavy rules. Both seek the same goals: increased vesting of those employees who would otherwise not vest, and increased benefits for those employees who would otherwise receive little, if any, pension benefits.

Finally, repeal of the top-heavy rules may be seen as a reward for those small companies <u>not</u> in compliance with the rules. In addition, the large number of small businesses that have made the effort to set up fair pension plans will be undercut by this policy reversal.

V. <u>ALTERNATIVE TO THE TOP-HEAVY RULES</u>

Proponents of repeal of the top-heavy rules, despite their recognition of the benefits to lower paid employees, fail to suggest adequate alternatives to the top-heavy rules. The top-heavy rules themselves need not be the only way to expand the fairness of each business' pension plan. AARP steadfastly

maintains that those employees currently helped by the top-heavy rules must continue to receive fair treatment. The Association is willing to look at other changes that can accomplish the same goals as the top-heavy requirements.

Towards this end, the small business community, assisted by the SBA, should work to develop either alternative rules, or a simpler model plan or plans that can be followed by small businesses without fear of violating current law.

In addition, small business owners need to receive more information on the private pension system and available options. Much of the lack of pension coverage is simply due to misunderstanding of what is available and fear of the "unknown complex world" of pensions. Educational efforts should be encouraged, and AARP, as it has shown in the past, is willing to aid in this effort. The Department of Labor, the SBA, and small business groups should increase their educational activities. While education alone cannot solve the problem, nor overcome the basic economic barriers to the establishment of small business pension plans, the Association believes adequate information is the basis on which other decisions can be made.

VI. ADMINISTRATIVE COST CREDIT

S. 1426 also proposes a tax credit for small business pension plans to offset the administrative costs of maintaining a qualified plan, including the SEP. The credit will equal 14 percent of contributions to non-highly compensated employees, and will be capped at $3000 for defined contribution plans ($4500 for defined benefit plans). To qualify for the credit, small plans will need to provide 100 percent vesting in four years.

The available evidence is not clear as to whether a small business pension tax credit will lead to further expansion of

pension plans. If not, it may only lead to a loss of revenue without justifiable benefits. In addition, the credit may distract attention from the real reasons for lack of pension plans among small businesses. If a credit can be shown to be effective, AARP is willing to support such efforts at pension expansion.

The low pension rate in the small business sector is a problem that must be attacked from several levels. Education is clearly one approach. Further tax incentives may be another approach. Development of model plans, and perhaps graduated compliance features for very small or new businesses may be helpful. Further development of all these approaches is clearly necessary, and a combination of these approaches is probably the most effective action.

VII. CONCLUSION

The lack of pension plan sponsorship in the small business sector is one of the major issues that must be addressed if private pensions are to become a more reliable source of retirement income. Public policy must ensure not only the expansion of pension coverage by a larger number of small businesses, but also the adequacy of pension benefits these plans provide to all employees.

The expansion of private pension coverage is one of the stated goals of S. 1426. Repeal of the "top-heavy" pension rules, however, will do little to promote the establishment of new plans. More important, for those new plans that are established, and for already existing plans, benefit protection for lower paid and shorter term employees will be diminished. Pension policy should ensure both the expansion of plan coverage and the adequacy of plan benefits for employees of all wage levels.

AARP again commends this subcommittee for addressing the problem of plan coverage in small businesses. The proposed tax credit, along with small business educational efforts, are among the approaches that should be explored in depth. AARP looks forward to working with the committee and Congress in developing effective ways to promote pension expansion, in meeting the needs of plan sponsors and plan participants, and in ensuring that tax subsidies for pension plans provide adequate benefits for future retirees.

Senator PRYOR. I am absolutely amazed at the growth in numbers of the AARP. When Senator Heinz and I were Congressman Heinz and Congressman Pryor, AARP had about 2 million members, or maybe 3 million. And now I guess it is the fastest-growing organization or association in the world.

Mrs. CROOKS. That is right, nonprofit.

Senator PRYOR. And I want you to know that we appreciate your statement. I also want you to know that when AARP speaks, we listen, and you have made a very, very eloquent statement this morning.

Mrs. CROOKS. Thank you.

Senator PRYOR. I hope that we can work out some of the concerns that you and this fine association have, and that is exactly why we are having this hearing this morning, to hear the pros and cons and the discussions, good and bad, about this particular approach.

Mr. Mason.

STATEMENT OF FRANK L. MASON, CHAIRMAN, LABOR AND EMPLOYEE BENEFITS COMMITTEE, U.S. CHAMBER OF COMERCE, BIRMINGHAM, AL

Mr. MASON. Mr. Chairman, I very much appreciate the opportunity of being with you this morning, and I appreciate your efforts on behalf of small business. While many people have looked on the U.S. Chamber as representing large business in the past, I can assure you that the majority by far of the membership of the U.S. Chamber is small business. And as a small business person, it has been my privilege to work with that group. I want to commend you and Senator Heinz for being involved in this effort and for what you are attempting to do.

The statement would be in the record, I understand, so I would like to spend just a few minutes talking with you about my experience as a small business person.

Senator PRYOR. Certainly.

Mr. MASON. With due respect to previous testimony from the AARP, I am not sure that that represents the membership's think-

ing, because I have some friends who are members, and I am eligible now myself.

The top-heavy rules are a problem for small business. The question has been raised would there be more plans. Personally, from my own experience, we have a company with less than 200 employees. We put in a profit-sharing plan in 1954. We have a pension plan that was added the next year. So we have both plans in our company.

I have for the last 2 or 3 years very seriously considered eliminating the pension plan, because of the things that we have talked about earlier, the additional requirements that are being imposed on the businesses to maintain those plans. In fact, I am just very close to eliminating the pension plan.

Why would I do that? I am interested in our employees; I feel that our benefit package is one of the advantages in working with our company. I even have helped form the Alabama Profit-sharing Council, to encourage more profit-sharing plans to be formed and to inform those that are involved in that effort in the State of Alabama. I am strongly supportive of employee benefits that the companies can afford and can provide.

The cost to our company of providing these plans, if you include all of the administrative costs for the pension trust, the whole thing probably runs in the neighborhood of $50,000 a year, for a small company. Now, with 200 people, you are talking about $250 a year, per employee. This is just the cost of administration.

The top-heavy rules require us to go through a complicated set of computations every year in order to qualify. We have all of our employees covered under profit-sharing. Everyone gets the same percentage to their annual earnings. There is no elimination of anyone. The pension plan would cover everyone except the outside commissioned salesmen, who have a little more control over what they make than a person on an hourly wage. So, we are broad in our coverage; we want broad coverage; but we must comply with these rules. The penalty for not complying is too great.

And I am still seriously considering the elimination of that pension plan because of the continued year-after-year requirement to update the plan, change it, and pay for practitioners to do that.

When we started, our pension plan and our profit-sharing plan, each had less than 20 pages. I could administer the profit-sharing plan. I got $500-a-year advice on actuarial computations for the pension plan. So, it was not a big deal.

Today, it is a major expense to comply with all of these rules. The cost for the PPGC has gone from $1 to $8.50; they are talking about $20; I have even heard $100 per employee. There again, I think the small business may be paying for the large companies that didn't fund their programs; but the costs have continued to escalate drastically, and I am pleased to see you exploring some opportunities to cut administrative costs.

One last thing: The excise tax that is imposed. If a plan is successful, and those who are in the position of deciding whether to continue or not are penalized by that excise tax, you may only get one person out of a company, but that may be the decisionmaker. And I would strongly recommend that the excise tax be eliminated, because there is no guarantee that current rates on income are

going to stay in the present range. They can be escalated. The excise tax simply is an added disincentive for the owner to continue those plans.

Thank you so much for allowing me to be here.

Senator PRYOR. A very fine statement, Mr. Mason.

[Mr. Mason's prepared statement follows:]

STATEMENT
on
THE "SMALL BUSINESS RETIREMENT AND
BENEFIT EXTENSION ACT" (S. 1426)
before the
SUBCOMMITTEE ON
PRIVATE RETIREMENT PLANS AND OVERSIGHT
OF THE INTERNAL REVENUE SERVICE
of the
SENATE COMMITTEE on FINANCE
for the
U.S. CHAMBER OF COMMERCE
by
Frank L. Mason
October 23, 1987

Mr. Chairman and members of the subcommittee, my name is Frank L. Mason, President of the Mason Corporation in Birmingham, Alabama. I am a member of the Board of Directors of the U.S. Chamber of Commerce and Chairman of the Chamber's Labor and Employee Benefits Committee. Also, I am the past Chairman of the Profit Sharing Council of America and was Chairman of the Alabama delegation to the 1986 White House Conference on Small Business. I am pleased to appear here today on behalf of the Chamber to extend our strong support for the "Small Business Retirement and Benefit Extension Act" (S. 1426). Accompanying me from the Chamber are James A. Klein, Manager, Pension and Health Care Policy, and Ann Yoshiura Trinca, Tax Specialist.

OVERVIEW

Mr. Chairman, you and your staff are to be congratulated for developing one of the very few positive legislative items relating to retirement policy in many years. All too frequently the business community, especially the small business community, has seen obstacles put in the way of efforts to expand retirement coverage for employees. In recent years, the unrelenting pace of legislative and regulatory changes related to retirement plans, to say nothing of the substance of many of those changes, has proven to be enormously costly and complex for businesses wishing to continue or initiate retirement plans.

The costs of complying with changes and of hiring the battery of experts -- attorneys, actuaries, accountants, benefit consultants, portfolio managers, and others who are necessary for the legal and prudent operation of a retirement plan -- are much greater, per employee, for the small business owner. Not surprisingly, the U.S. Small Business Administration has reported that only 19 percent of workers in firms with fewer than 25 employees have retirement plans, compared to 86 percent for firms with 500 or more workers.

Since most jobs in recent years have been generated in the small business sector, we face the likelihood of fewer, rather than more, workers having employer-sponsored retirement plans. Such a trend will inevitably lead to greater pressure on individual savings and Social Security to meet the retirement income security needs of the American public. This should not be allowed to happen. We need to expand the voluntary employer-provided retirement system. Allow me to describe, then, the Chamber's interest in the various provisions of S. 1426, which will help to meet this goal.

Repeal of the "Top-Heavy Rules"

The so-called "top-heavy" rules, incorporated in the Tax Equity and Fiscal Responsibility Act of 1982, are designed to ensure that a disproportionate level of tax-favored benefits are not directed to the highly compensated employees of a firm. Whatever the merits of such a policy, the continued existence of top-heavy rules is plainly unnecessary in order to achieve their purported goal in light of changes made in the Tax Reform Act of 1986 (TRA). Indeed, if the purpose of top-heavy rules is to expand pension coverage to employees who might otherwise not have it, then continuing those rules in the post-TRA era is a cruel hoax on the very people who are intended to be helped.

Given the new nondiscrimination rules for all plans that are required by the TRA, the top-heavy rules only act as duplicative and costly requirements that discourage employers from establishing tax-qualified retirement plans. The result will be less, rather than greater, coverage under pension plans.

Moreover, repeal of the top-heavy rules would be absolutely consistent with the stated goals of the broader nondiscrimination rules incorporated in the TRA. In 1985, Senator John Heinz, upon introduction of the "Retirement Income Policy Act," some of whose terms were incorporated in the TRA, stated:

> Although this legislation has proposed uniform rules for retirement and nonretirement plans in general, one set of unique rules -- the so-called top-heavy rules -- remain left untouched by this bill. We recognize that it is awkward to leave a series of special rules based largely on plan size in place in a bill purporting to establish consistent policy for employer-sponsored plans. Once the kinds of benefit protections provided to employees of small firms through the top-heavy rules are adopted more broadly, these special rules and the elaborate definitions of top-heavy plans should be dropped from the Internal Revenue Code. 131 Congressional Record S13802 (1985)

Quite simply, it would be unfair--and would undermine the very worthy goal of expanded coverage -- if Congress failed to take corrective action with

respect to the top heavy rules now that new nondiscrimination rules have been enacted.

Administrative Tax Credit for Costs of Maintaining Qualified Plans

The Chamber supports the tax credit to offset a portion of the administrative costs of maintaining a qualified plan. The credit is not a panacea for the cost burdens imposed on small plans, but it would help to defray the added per plan participant burden that small firms necessarily must bear. The Chamber, of course, is concerned about the revenue loss implications of any tax credit. However, the modest level of the credit and its phaseout feature for companies with fewer than 100 workers should help to reduce its impact on the Federal Treasury.

Moreover, as is always the case when individuals' income security is at issue, Congress must weigh the indirect revenue loss of a tax incentive for the private sector against the revenue loss if the federal government had to ensure economic security directly through greater public program benefits.

Simplification of Forms and Reporting Requirements

Perhaps no aspect of S. 1426 will be as warmly embraced by some small businesses as the provision to simplify the Series 5300 and 5500 pension plan reporting forms and to allow firms with fewer than 100 employees to notify plan participants of the availability of a plan's annual report rather than automatically providing each employee with a copy of the report.

Both of these changes would go a long way toward lifting the yoke of regulatory requirements on small firms. For many firms, the added cost of hiring experts to complete government forms or issuing annual reports reduces the amount of money the employer can contribute to the pension plan itself. For others, it is a cost and burden that dissuades them from offering a plan at all. The proposed simplifications are much needed.

Repeal of Excise Tax on Certain Distributions

The TRA imposes a new 15 percent excise tax on distributions in excess of $150,000 from qualified plans. The results of this provision are very much a concern. This tax penalizes highly compensated employees who are participants in plans that have positive yields on investments and those individuals who are covered by employer plans and also have Individual Retirement Accounts.

Such a tax policy seriously discourages prudent and successful investment of pension assets. In addition, it sends a signal to owners of small businesses--the very people who make the decision whether or not a firm will have a retirement plan--that they are to be penalized, rather than rewarded, for establishing a plan and responsibly managing it.

The small business owners of this country are the champions of free enterprise who assume enormous personal financial risk to establish and operate their companies. If they make the additional commitment to ensure retirement income protection for their employees and fulfill that commitment, is there any possible rationale for unduly taxing the owners and employees and, thereby, discouraging the creation of these plans? The obvious answer is "No." We applaud the provision of S. 1426 that repeals this ill-advised excise tax.

Establishment of Tax-Sheltered Annuities for Tax-Exempt Organizations

During the tax reform process, the Chamber and the American Society of Association Executives spearheaded the effort to save the 401(k) cash or deferred annuity plan for employees of tax-exempt organizations. These organizations, such as nonprofit hospitals, charitable organizations, labor unions, cooperatives, state and local chambers of commerce, and trade and professional associations, have found these retirement plans to be very important tools to attract and keep talented employees and to ensure retirement income protection where other types of plans are not available or unaffordable. The TRA spared the 401(k) plan for all tax-exempt entities that had established a plan prior to July 1, 1986.

We believe that it is vital that such plans or comparable plans be extended to all tax-exempt organizations that wish to establish them. There is no justification for so unfairly discriminating against employees simply because of the tax-exempt status of their employer. The Internal Revenue Code Section 457 plans, which were expanded under the TRA, are non-qualified plans and 457 plans are not protected against the claims of creditors. This places an unacceptable risk on employees and makes the 457 plan unattractive to private-sector tax-exempt organizations. Accordingly, the expansion of tax-sheltered annuities (Section 403(b) plans) under S. 1426 is a welcome relief to the employees of tax-exempt entities. We heartily endorse this provision.

Welfare Plan Nondiscrimination Rules

Perhaps no aspect of the employee benefit provisions of the TRA has generated more confusion than the so-called welfare plan nondiscrimination rules. These rules represent a major new degree of complexity for sponsors of health and welfare plans. The likelihood that these rules could become effective as early as three months following the issuance of nondiscrimination regulations by the U.S. Department of the Treasury or on January 1, 1989, even without regulations, is nothing short of absurd. Employers simply will not be able to comply properly with the law without regulations and certainly are entitled to more than three months lead time to implement rules that are so complex. This problem is severe for large and small businesses, alike, and for their employees.

S. 1426 wisely delays the effective date of these rules. Without delay, many employers will have no alternative except to drop coverage altogether or limit severely the choice of benefits available to employees. Such a result will not meet the interests of employees, employers, the U.S. Department of the Treasury or Congress, which conceived these complex rules. We warned of this result during the tax reform process. Although Congress did not recognize at that time the detrimental effect of its action, at least it should do so now that businesses are being forced to waste vast sums of money to try to comply with rules whose need was never even the subject of a Congressional hearing.

Conclusion

The Chamber applauds you, Mr. Chairman, for your recognition of the particular need to address the problems faced by small businesses in extending retirement savings plans to employees. We note that the objectives of S. 1426--greater parity between large and small company plans and simplification of paperwork requirements related to retirement plans--were advocated as Recommendation number 20 at the 1986 White House Conference on Small Business. These are issues of major significance to the American small business community.

The "Small Business Retirement and Benefit Extension Act" would provide much-needed relief and improve the lives of millions of Americans. The Chamber is pleased to have helped in the technical development of some aspects of this bill and stands ready to assist you in making any necessary improvements and in ensuring its passage.

Thank you.

U.S. CHAMBER OF COMMERCE

November 23, 1987

The Honorable John Heinz
United States Senate
Washington, D.C. 20510

RE: S. 1426 "Small Business Retirement and Benefit Extension Act"

Dear Senator Heinz:

During the October 22, 1987 hearing on the above-referenced bill, you questioned the panel of witnesses, including the U.S. Chamber of Commerce's witness, about the written testimony of the U.S. General Accounting Office regarding "Vesting Status of Selected Participants in Top-Heavy Pension Plans." The relevant charts contained in that testimony, that were the basis for your question, are attached.

You inquired as to whether the charts indicated that the "top heavy" vesting standards provide for greater vesting than the vesting standards contained in the Tax Reform Act of 1986, (TRA).

Since the witnesses did not have an opportunity to study the charts in advance, one point that may not have occurred to them at the time bears noting on further reflection. The TRA requires a new set of participation and coverage rules which, if they have the purported desired effect, would expand coverage and, in turn, result in more people becoming vested in pension plans. The comparison made by the General Accounting Office may only have compared the vesting standards of the TRA with the top heavy vesting standards, without considering the other extensive changes made by TRA.

Additionally, comparison of the charts would seem to suggest that the loss of vesting between the application of the top heavy rules and the TRA rules occurs only for those individuals working more than two and less than three years. That group of people may be far less than the number of people who never become vested at all due to top heavy rules that either discourage companies from establishing pension plans or encourage firms to discontinue such plans.

Thank you for the opportunity to more fully respond to the question you posed to the U.S. Chamber and other witnesses. We request that this letter be included in the formal hearing record.

Sincerely,

James A. Klein
Manager, Pension and
Health Care Policy

Attachment

cc: The Honorable David Pryor
Chairman, Subcommittee on Private Pension
Plans and Oversight of the Internal
Revenue Service

Senator PRYOR. Mr. Kushner.

STATEMENT OF GARY KUSHNER, FOUNDER AND PRESIDENT, KUSHNER AND COMPANY, TESTIFYING ON BEHALF OF NATIONAL SMALL BUSINESS UNITED, KALAMAZOO, MI

Mr. KUSHNER. Good morning, Senator Pryor and Senator Heinz.

I am the founder and President of Kushner and Company, a national employee benefits consulting and administration firm headquartered in Kalamazoo, Michigan. It gives me a great deal of pleasure to appear here today, to tell you on the record that the NSBU wholeheartedly and without qualification supports S. 1426.

I am also honored that the Board of Directors of the National Small Business United asked me to testify on behalf of their more than 50,000 small business members nationwide on this very key small business issue.

I understand that you have also been instrumental on a number of other important small business initiatives, and I want to publicly express NSBU's appreciation. Your leadership on such issues as the Taxpayers' Bill of Rights, Prompt Pay, Regulatory Flexibility, Equal Access to Justice, Paperwork Reduction, and your support for having a small businessperson to serve on the Federal Reserve Board is greatly appreciated.

As you and the other members of the subcommittee know, NSBU is a national multi-industry, small business trade association whose membership is composed of individual companies in each of the fifty States.

My statement today will focus more on the philosophy of why NSBU is so supportive of S. 1426 rather than the more technical aspects of the bill; although, I will, briefly, touch upon them. My purpose in proceeding in this manner is to make it perfectly clear, to those who either do not understand small business or who have a limited knowledge of its key role in our economy, why it is vital that your proposal be enacted. However, at the conclusion of my statement I would be delighted to answer any technical questions that might arise; helping small to medium-sized companies with pension and benefit problems is my business.

S. 1426 encourages and provides incentives to small firms to create pension plans. It does not mandate small firms to create them. And this approach, one of encouragement, reflects well on you, Senator Pryor. Obviously, you have looked very carefully at why small business is not covering their employees with pension plans and found some very compelling reasons: First, they are terribly complex; and, second, the administrative and maintenance costs are probitive. And what does your bill do about them? It remedies these problems. I cannot overstate the importance of such an approach.

Your approach will be successful. And it stands in stark contrast to the approaches of the plethora of mandated benefits bills now being considered. Indeed, if one looks closely, there are reasons why small business has difficulty providing health insurance, just to cite one example. But those reasons are being ignored; instead, some in Congress have decided, "We'll just pass laws to force small business to provide benefit X or benefit Y." Assumptions are made

that small business somehow doesn't care about providing good benefit packages to its employees. These assumptions then lead to the wrong conclusions, and such conclusions—if enacted—will force many small firms out of business.

I formed my business 5 years ago to answer what seemed to me to be the pressing employee benefit needs of small to medium-sized employers. As a human resource professional myself in small to medium-sized businesses, I was frustrated when I tried to implement new benefit programs for employees, particularly flexible benefit "cafeteria plans" and retirement programs. We were told that we were too small to have such plans, that the administration and required Government filings were too complex for us, and that the large consulting firms were much too expensive for employers of our size.

We found that only by approaching this area in a new way could the small employer be totally satisfied with what was being done in these areas.

Our success in implementing plans that meet the needs of both employees and the employer attest to the fact that small employers wish to establish benefit programs but are often frightened off by the complexity of the laws they must face. I know, because that is why I started my business. Small firms want to provide these benefits; they just don't know how.

S. 1426 also recognizes the importance of the White House conference on small business priority No. 20. The small business delegate to the second White House conference endorsed the concept of promoting retirement security by promoting the continued viability of private retirement systems in the small business community. These avenues of interest to small business were to achieve parity between large and small plans, and to simplfy both the filing and the paperwork requirements of those plans.

Your bill would make these recommendations law.

If the cost of maintaining an employee pension plan doesn't preclude a small business owner from creating one, the complex forms and filing requirements will. Your bill alleviates these impediments by repealing the administratively complex "top-heavy" rules by requiring simplified reporting forms, and by allowing employers to notify their employees regarding the availability of annual reports, rather than requiring employers to furnish the reports themselves.

The bill is a much-needed tool in helping the small employer plan his benefits program.

I would be happy to try to answer any of your questions.

Thank you.

Senator PRYOR. Thank you very much, Mr. Kushner. We appreciate your attendance and your sharing your knowledge with this committee this morning.

[Mr. Kushner's prepared statement follows:]

GARY KUSHNER
FOR
NATIONAL SMALL BUSINESS UNITED
IN SUPPORT OF
S.1426, THE SMALL BUSINESS BENEFIT AND RETIREMENT
EXTENSION ACT

Good morning, Senator Pryor.

My name is Gary Kushner. I am the founder and President of Kushner and Co., Inc., a national employee benefits consulting and administration firm headquartered in Kalamazoo, Michigan.

It gives me a great deal of pleasure to appear, here today, before the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service to tell you on the record...

NSBU WHOLEHEARTEDLY AND WITHOUT QUALIFICATION SUPPORTS S. 1426,

the Small Business Benefit and Retirement and Extension Act, which you introduced back in June. I am also honored that the Board of Directors of National Small Business United (NSBU) asked me to testify on behalf of their more than 50,000 small business members, nationwide, on this key small business issue.

I understand that you've also been instrumental on a number of other important small business initiatives--and I want to publicly express NSBU's appreciation. Your leadership on such issues as The Taxpayers Bill of Rights, Prompt Pay, Regulatory Flexibility, Equal Access to Justice, Paperwork Reduction, and your support for having a small business person to serve on the Federal Reserve Board is greatly appreciated.

As you and the other members of the Subcommittee know, NSBU is a national, multi-industry, small business trade association

whose membership is composed of individual companies in each of the fifty states, as well as local, state and regional organizations, and one national trade association. Formed from the merger of Small Business United (SBU) and National Small Business (NSB), NSBU has been speaking out on behalf of small firms for 50 years. And, Mr. Chairman, we're looking forward to this important responsibility for at least another 50 years.

My statement, today, will focus more on the philosophy of why NSBU is so supportive of S. 1426 rather than the more technical aspects of the bill--although I will--but briefly--touch on them. My purpose in proceeding in this manner is to make it perfectly clear, to those who either do not understand small business or who have a limited knowledge of its key role in our economy, why it is vital that your proposal be enacted. However, at the conclusion of my statement, I would be delighted to answer any technical questions that might arise--helping small to medium-sized companies with pension and benefit problems is my business.

S. 1426 encourages and provides incentives to small firms to create pension plans--it doesn't mandate small firms to create them. And this approach--one of encouragement--reflects well on you, Senator Pryor. Obviously, you've looked very carefully at why small business isn't covering their employees with pension plans and found some very compelling reasons: 1) they are terribly complex, and 2) the administrative maintenance costs are prohibitive. And what does your bill do about them? It remedies these problems--that's what. And I cannot overstate the importance of such an approach.

Your approach will be successful. And it stands in stark contrast to the approaches of the plethora of mandated benefits bills now being considered. Indeed, if one looks closely, there are reasons why small business has difficulty providing health insurance, just to cite one example. But those reasons are being ignored--instead,

some in Congress have decided "we'll just pass laws to force small business to provide benefit X or benefit Y". Assumptions are being made that small business, somehow, doesn't care about providing good benefit packages to its employees. These assumptions then lead to the wrong conclusions and such conclusions--if enacted--will force many small firms out of business.

If you had drafted S. 1426 in such a manner, Senator Pryor, your bill would simply mandate that all small firms provide pension plans funded at a certain level--period.

I formed my business five years ago to answer what seemed to me to be the pressing employee benefit needs of small to medium-sized employers. As a human resource professional, myself, in small to medium-sized businesses (of from 100 to 800 employees), I was frustrated when I tried to implement new benefit programs for employees, particularly flexible benefit "cafeteria plans" and retirement programs. We were told that we were too small to have such plans; that the administration and required government filings were too complex for us; and that the large consulting firms were much too expensive for employers of our size. At the same time, I found that many of my peers were receiving similar information. It was then that I decided to form a consulting firm to assist these employers in answering these questions. Very early in my business planning process, I decided that the new firm would function solely in a consulting and administrative role, and would not sell any products nor accept any commissions or finders' fees for such services. Only in this way could the small employer be totally satisfied that the recommendations being made were in their interests alone.

Our success, in implementing plans that meet the needs of both employees AND their employers,, attests to the fact that small employers wish to establish benefit programs but are often

frightened off by the complexities of laws that they must face. I know, because that's why I started my business--small firms want to provide these benefits--they just don't know how.

S. 1426 takes the future into account. Future population trends suggest that our population will be growing older. Put another way--the "baby-boomers" are going to be retiring. It's a fact that growing employment in the small business sector coupled with the inability of small firms to provide retirement plans would have disastrous effects on future economic climates and conditions by increasing the number of individuals relying solely on Social Security. And we've seen, a number of times, what happens when the Social Security system gets into trouble--Congress "fixes" it by increasing payroll taxes. It's refreshing to note that this bill not only helps small business now--it helps everyone later on.

S. 1426 recognizes the importance of WHCSB Priority #20. The small business delegates to the 2nd White House Conference on Small Business (WHCSB), in Priority #20, endorsed the concept of "promoting retirement security by promoting the continued viability of private retirement systems in the small business community". As a delegate to the conference, myself, we clearly identified a number of avenues by which to achieve this that were favorable to small firms and to other organizations. Those avenues of interest to small business were 1) achieving parity between large and small plans, and 2) simplifying both filing and paperwork requirements.

Your bill would make these recommendations law. I'd like to touch--briefly--if you don't mind on why parity and simplification are important.

PARITY: One of the impediments to small firms in providing pension plans is that it costs--in some cases--nearly twice as much to administer them as it costs large firms. Your bill addresses this problem by providing a credit equal to 14 percent of contributions to non-highly compensated employees. In addition, your bill would repeal the top-heavy rules, the need for which were obviated by the Tax Reform Act of 1986.

COMPLEXITY: If the cost of maintaining an employee pension plan doesn't preclude a small business owner from creating one--the complex forms and filing requirements will. Your bill alleviates these impediments by repealing the administratively complex "top-heavy" rules, by requiring simplified reporting forms, and by allowing employers to notify their employees regarding the availability of annual reports rather than requiring employers to furnish the report, itself.

NSBU looks forward to working with you in your efforts to assist small business in its desire to attract and retain the best possible employees--S. 1426 is a much needed tool in this regard.

I'd be happy to try and answer any questions.

Senator PRYOR. I don't have but one or two questions.

First of all, Mr. Schneier, as Mr. Kushner has brought up the issue of mandated benefits versus voluntary, what effect would mandated pension benefits have on most of our small businesses out there in America today?

Mr. SCHNEIER. Mandating pensions would make them very unhappy, I think, first of all.

Again, the cost factor. I mean, it would impose a tremendous cost factor on small employers to mandate them to provide pension coverage. Of course, it would depend on what type of pension coverage we were talking about. I mean, many small employers feel they are already being mandated to provide some pension coverage through Social Security, for which they don't receive much benefit at this point, because of the changes in the integration rules which occured last year. So, from their perspective, they are providing some benefits at this point.

Implementing a new mandated system of pension coverage would certainly create some severe difficulties. From the profitability point of view, many small business owners would have severe difficulty just in meeting those additional costs, where they currently may be in marginal situations.

Senator PRYOR. Maybe for the three of you, this question: In 1986 under the Tax Reform Act we lowered individual and business tax rates; are any of these savings—if they are in fact savings—now being utilized in the area of more pension plans or more flexibility in pension programs, or liberalizing any of the existing plans? Do you know of this taking place?

Mr. SCHNEIER. It is probably too soon to tell, because they still haven't filed a business tax return yet, under Tax Reform, and I think they are still trying to sort of understand where some of the changes are going to be.

Senator PRYOR. We are, too, I might say. [Laughter.] Mr. Mason, would you like to comment?

Mr. MASON. Well, I think that many people in the business community have not felt the benefit yet and are not sure they will ever feel the benefit. And I think there is a hesitancy, because a pension commitment is more of a long-term commitment, and what can be given can be taken away in the area of tax relief, and I am not sure that the business community—one point, too, that sort of ties in with this mandated benefit: It was about 8 years or so after we began business before we got into a profit-sharing plan this way. So, I think that the mandate benefits may put an undue burden on a business for the first 10 years of its existence. It may not be able to afford what later it can begin to afford, some things, and to put that burden on that business at the start-up phase would be an insurmountable obstacle for many businesses, and it could impair the ability of new businesses to form and for them, again, to grow enough to be able to afford those things. So, I think that is an aspect.

Senator PRYOR. Mr. Kushner, any comments?

Mr. KUSHNER. Mr. Chairman, if I could address the mandated aspects versus providing incentives and encouragement, the problem with mandating any benefit—whether it be parental leave or health coverage or pension coverage—is that, unless Congress is

going to mandate 1) profits, at the same time, 2) the entire benefit package for all employers of all sizes across the board, we are dealing with shifting sands, and what will begin to occur if one area becomes mandated, that will reduce benefits being provided to employees in other areas.

The large growth that Congress has been, very fortunately, a big part of is cafeteria style—flexible benefit plans where employees can tailor their benefits package to fit their needs—which has arisen because there have not been those types of mandates in the various areas.

And we see more and more direction in bills proposed before Congress towards mandating benefits. I fear that it will not have a very good effect unless, as I say, Congress is going to mandate profits and mandate the entire benefit package at one time.

Senator PRYOR. Thank you.

Senator Heinz?

Senator HEINZ. Mr. Chairman, thank you.

Mrs. Crooks, earlier we had testimony that the maintenance of the top-heavy rules, at least in the judgment of the Small Business Administration, would bring about a continuation of plan termination by small employers. How much credence do you give to that? And, if you do give it credence, what should we do?

Mrs. CROOKS. Well, we don't give a lot of credence to that. And of course what we are mostly interested in is for adequate benefits for all employees.

One of the reasons we favor the top-heavy rules is that, as you may know, we have 2.5 million women over 65 years of age who are living in poverty today, and some of those women could have been out of poverty if they had had some pension benefits.

We want a better distribution for the lower-income and for women, and not all of it going to the high-income people.

Senator HEINZ. You say you don't give the SBA analysis credence. Why? Where is their analysis flawed, or what statistics are there that suggest they are wrong?

Mrs. CROOKS. Well, you know I am not the tax expert as all these fine people are here today, because I am a volunteer. I have brought with me David Certner. Would you mind if he would respond to that?

Senator HEINZ. I would be very pleased.

Mr. Certner.

Mr. CERTNER. Senator, in response to that, I can only look back to what you asked the panel earlier, when you asked if there would be a significant increase in the number of plans if we repeal the top-heavy rules. I noticed that there was a noticeable pause from the witnesses on whether or not there would be any kind of increase. And they thought it was largely speculation on their part as to whether repeal of the top-heavy rules themselves would encourage the establishment of more plans or discourage exisitng plans from providing continued benefits.

Senator HEINZ. Yes.

Mr. CERTNER. I think that pause was fairly significant.

Senator HEINZ. It doesn't answer the question I asked, though, which is as regards not plan formation but termination.

Mr. CERTNER. We don't see any evidence.

Senator HEINZ. SBA testified that plan termination would continue, that there were a significant number of plan terminations, and that this situation would continue but would be abated by repeal of the top-heavy rules.

Mr. CERTNER. Well, I didn't see any evidence to back up that statement. I think there are a number of reasons why plans have been terminating in the past number of years, and many of them have been for economic reasons. I think the panel this morning alluded not just to the top-heavy rules, but to a vast number of rules in the pension area which are fairly complex for the small businessman, and we can agree with that.

What we don't understand is why, of all the rules that are out there, they are picking on the top-heavy rules. One thing that we do know about the top-heavy rules is that these rules benefit low-income people, especially women who generally, because of their work histories and their places in small businesses, don't vest and don't gain access to the pension system.

This is something that we do not have to speculate about. We know people will be hurt if we do repeal the top-heavy rules. And what we are saying is, if you think these rules are too complex, give us an alternative. We are not saying that the top-heavy rules are the greatest thing in the world; what we are saying is, the intent and what they accomplish is, and we want to keep that. And if we can come up with a better alternative, then we would like to see that.

Senator HEINZ. I want to ask a question of the other panelists, but first I would like to commend Gary Kushner who, in addition to running his own business and being involved with the National Small Business United, has been coming into Washington as often as he can to participate with our working group.

Mr. Kushner, I want to thank you on behalf of myself and of this committee, as well as the Committee on Aging, for your very generous volunteering of your time. It has been very helpful, and we hope you can continue to participate in the benefits working group.

Let me ask you and your fellow panelists: Mrs. Crooks says that there may be a better alternative than the top-heavy rules. She has suggested a model pension plan, about which I want to ask her a little bit more in a moment; but she says, and the GAO report would appear to substantiate, that if the top-heavy rules were repealed there would be a larger number of either non-covered, non-qualified, or nonvested people who would tend to be female and poorer.

First, do you agree that that is likely to be true? And if you do—and I say this to all three of you—what is the answer to that?

Mr. KUSHNER. Well, I think, if I could, Senator Heinz, make a couple of comments: I suppose if I take a bucket of sand out of the desert, I am not necessarily going to increase business travel through the region. I am saying that in regard to the way the top-heavy rules have been affected.

I think it is very important that we are here today, when a year and a day ago the Tax Reform Act of 1986 was signed into law. I think that is important because, until that Tax Reform Act had been signed into law, there was a need for the top-heavy rules as

put forth by TEFRA. But the Tax Reform Act had a number of provisions that affected retirement plans in the private sector:

Foremost, there was accelerated vesting, which is extremely close to the top-heavy accelerated vesting requirements, and all plans will now be subject to this.

There was a cap on the compensation that can be considered within any retirement plan, not just top-heavy plans but it applies to all plans, large and small.

There are minimum-benefit requirements. There is the lack and the lessening of the ability to integrate out an employee, who may in the past have tended to be lower-paid, may have been female, since the data seems to show that a number of people in that demographic group did change jobs somewhat more often.

With the passage of the Tax Reform Act and its many provisions that affect retirement plans, the need for the top-heavy rules was obviated. There is very little difference today under Tax Reform, once all of the effective dates hit us, between the new Tax Act that affects all and the top-heavy plans which only affect small business. And the doubling and the tripling of the administrative burden on those small employers is no longer necessary since the passing of Tax Reform.

Senator HEINZ. The GAO report, which I gather is not widely available—have you seen the GAO report?

Mr. KUSHNER. I am not sure of the one you are referring to.

Senator HEINZ. Well, it is dated 10:00 a.m., Friday, October 23.

[Laughter.]

Mr. KUSHNER. I am sure I have not seen it yet, no. I think they left them on the table and ran.

[Laughter.]

Senator HEINZ. That is the one.

Now, if you turn to page 4 of that—would you share a copy with Mr. Kushner?

Mr. KUSHNER. Thank you.

Senator HEINZ. If you turn to page 4 of that report, there are some pie charts, and figure 1 compares top-heavy vesting, 2- to 6-year graded, which is I guess what most small employers under top-heavy are using, it has 16 percent not vested.

Over to the right there is the option that it is assumed most small employers would involve themselves with, in 3- to 7-year graded vesting under the Tax Reform Act, as opposed to the 5-year cliff which larger employers tend to use. And according to the GAO, this indicates that almost twice as many people would not vest.

Now, I understand that you have not seen this report, and I am not trying to throw you a curve ball, but if the report was accurate—a big "if"—and, therefore, it would appear to contradict what you said a moment ago, would you still maintain that the repeal of the top-heavy rules would not result in loss of benefits? In effect, that the GAO report was probably flawed in their conclusions?

Mr. KUSHNER. Obviously, without having had a great deal of time to study this, the first thought that comes to mind as a practitioner in the field is that there are only 128 plans of small businesses being surveyed here. That is certainly not a very large sample.

But second, even given the statistics that the AARP presented us before, if the average time spent at one job is over 3 years, then certainly there will be partial vesting in all cases. And all we are looking at here is the difference between those employees who stay at a job 2 years and those who stay for 3 years, since there is a part of the graph for partial vesting, versus fully vesting, versus no vesting.

And I think there can be some arguments made on both sides that are we looking to protect those employees who work from 2 years to 3 years, and that there is a greater public, societal need for that; or are we looking at how this affects all employees of all small employers? And just from looking at the graphs, what we are really seeing is the distinction between an employee with 2 years' tenure and an employee with 3 years' tenure.

Senator PRYOR. What are we talking about, if I might interrupt, Senator Heinz? What are we talking about in terms of dollars?

Can you attach a dollar figure onto this?

Mr. KUSHNER. Well, in terms of the vesting difference, we are only talking about 20 percent of what would eventually be a full benefit, and we are only talking about it with people of tenure from 2 to 3 years. It is going to be extremely small. I can't put a dollar, because each plan is going to be designed a little differently—it depends on if it is a defined-benefit or a defined-contribution plan. The administrative cost, I can tell you, for the distinction of that 1 year of tenure, that 1 year of seniority, is double, triple, and sometimes four times the cost to the small employer, dollars that could be, instead, better funneled into the plan, into providing benefits for all rather than going to pay administrative costs.

Senator HEINZ. Let me ask one last question.

Mrs. Crooks, would you comment a little bit more fully about what I think is a proposal you are making on page 10 of your statement, where you suggest that an alternative to the repeal of the top-heavy rules is something you call a "model pension plan." Let me ask you, are you envisaging some kind of scenario where a top-heavy plan would be given a choice of either staying a top-heavy plan or participating in a new creature called a model pension plan?

Mrs. CROOKS. We have been thinking about a model pension plan, and to develop a model plan that would provide adequate benefits for the lower-income worker, and that are more administratively simple—because I gather the plan right now is very difficult to administer—and that would comply with the goals, though, of the top-heavy rules, that the lower income people would still benefit from the plan.

Senator HEINZ. Let me ask of the panel: In concept, is this something that is worth pursuing? Would it work? Is there potential in this idea, from what you all know?

Mr. Schneier.

Mr. SCHNEIER. Senator, I would say there probably is something that could be looked at in terms of establishing a model plan which small employers could look at as a prototype, and to try to put some of these administrative costs out of the way.

May I also comment on some of the previous comments on vesting, if I could take just a moment?

Senator HEINZ. Certainly.

Mr. SCHNEIER. I think there is far too much reliance put on the issue of vesting in and of itself. Whether it is 3 years or 5 years is not as much the issue of the administrative costs of the top-heavy regulations imposed on top of what the Tax Reform Act of 1986 imposes.

In my testimony, and I think several other people have also mentioned it, there are different definitions. You have "key employee" definition under top-heavy, you have a "highly compensated" definition under the Tax Reform Act of 1986. These areas don't always necessarily intertwine and cause a lot of the complications for filing plans and for maintaining plans.

So, I think the question of whether 3-year vesting or 5-year vesting as the critical issue is probably overplayed.

Senator HEINZ. Thank you very much.

Mr. Mason, do you have a comment?

Mr. MASON. One other thought, with regard to the top-heavy. One of the things that the GAO doesn't consider, and I don't think it has been discussed in answer to your question there, was the number of plans that might be terminated because of this additional complication that has been added. And those plans may not be terminated if we could be freed of these top-heavy rules, since the top-heavy rules have been addressed in the later Tax Act, anyway. It is a duplication as it stands, and it may very well make the difference for companies such as my own, that would either continue the pension plan or do away with it. So, I think that is an aspect that needs to be considered. For others who are not faced with these annual costs of maintaining these plans and having somebody go through these computations, it doesn't mean much to them. But if you are signing the check to pay for that annual cost, it makes a difference, as to whether you have duplicating requirements to meet and further complications.

So, I think that the top-heavy rules will play a part in how many plans in existence continue to be in existence, as opposed to how many more plans might be formed if we eliminate them.

Senator HEINZ. Mr. Mason, thank you.

I want to thank all of the panelists, Mr. Chairman. They have been very, very valuable witnesses.

I need to apologize to you, Mr. Chairman, and to them, because I have a witness from our Pennsylvania Department of Environmental Resources appearing before the Governmental Affairs Committee right now on S. 342, and I have some questions I have to ask him, too.

So, thank you, Mr. Chairman.

Senator PRYOR. Senator Heinz, we apprecate very much your participation.

Senator HEINZ. I commend you especially on addressing an important issue and having so skilled and knowledgeable a panel of witnesses as these and the others are.

Senator PRYOR. Thank you, Senator.

Mr. Certner, did you have a comment a moment ago? Did you want to comment on any of the subject matter?

Mr. CERTNER. Nothing further, thank you.

Senator PRYOR. All right.

Mr. Kushner.

Mr. KUSHNER. Mr. Chairman, if I could address the issue of a model plan for a moment, again I get to look back a year and a day to the Tax Reform Act. One of the provisions of the Tax Reform Act was that the IRS was directed to put forth a model 401(k) plan, a model prototype plan, which the IRS did indeed come out with this year.

It is interesting that, as a practitioner in the field, it is gaining virtually no acceptance among small business employers. Now, these are people who would be able to utilize that plan at little if any cost in terms of set-up cost.

Senator PRYOR. Why is there no acceptance?

Mr. KUSHNER. There is little or no acceptance, because many of the provisions that the IRS put into its model plan—which of course cannot be amended or modified—are not the types of 401(k) designs that the small business employer would normally include. They disallow items that are certainly allowable within the law, which if drafted separately would be allowed in a qualified plan; but it is written in such a narrow context that it is not appealing to many small employers. They are willing in this case to spend a little bit more in set-up costs to have a self-designed program.

And I ought to point out that my firm does not advocate that position, necessarily, because we are not in the business of selling designed 401(k) plans. And here is a good example where an opportunity for the small business owner is put aside in order to do some of the work in a manner that is to their liking.

Senator PRYOR. Thank you, Mr. Kushner.

I hate to do this, but I think we are going to have to move to our next panel. Is there any final, quick comment any of our witnesses might like to make this morning?

[No response.]

Senator PRYOR. If not, we want to express the gratitude of this committee for your appearance this morning. Thank you very much, it was very informative.

We will call our third panel at this time.

Gentlemen, we are getting ready to hear the status of the 403(b) issue. We first have Mr. Robert M. Wilson, vice president of personnel programs for the Johns Hopkins University, who is today representing the American Council on Education and higher education associations;

Mr. Joe Heusi, president and chief executive officer, the Variable Annuity Life Insurance Co.;

Mr. Vince Robison, chairman of the board, American Society of Association Executives;

Mr. Leon Matthews, the president of United Way of Pulaski County—I might say Pulaski County, AR—and we are very glad that he came from our State to be with us today; and

Mr. Chris Semos, the county commissioner of Dallas County, and the United Way is well represented from Dallas County.

So I think first we will call on Mr. Robert Wilson.

STATEMENT OF ROBERT W. WILSON, VICE PRESIDENT OF PERSONNEL PROGRAMS FOR THE JOHNS HOPKINS UNIVERSITY, TESTIFYING ON BEHALF OF THE AMERICAN COUNCIL ON EDUCATION AND HIGHER EDUCATION ASSOCIATIONS, BALTIMORE, MD

Mr. WILSON. Mr. Chairman, in addition to my duties at the Johns Hopkins University, I serve on several committees and commissions within higher education—I am chairman of the National Benefits Council of the College and University Personnel Association, I am a member of the Benefits and Personnel Committee of the Business Officers Association, and serve on the Faculty Retirement Committee of the Consortium on Financing Higher Education.

As you indicated, I appear today on behalf of the American Council on Education, and the other associations that are listed on the cover of the statement that I wish to have entered into the record.

Senator PRYOR. Your statement will be placed in the record in full.

Mr. WILSON. I certainly appreciate the opportunity to appear before this subcommittee to discuss an issue that is of major importance to higher education.

The issue essentially comes down to a plea for more time in dealing with what essentially is a sea change in the kinds of ways that we treat retirement issues within the tax-exempt not-for-profit higher education community.

The Tax Reform Act of 1986 mandated that sea change, and we are simply asking, and supporting section four of the act that we have in front of us, to delay the imposition of certain of the rules dealing with nondiscrimination until a period of two years after the issuance of the final regulation.

We certainly believe the postponement of the effective date is fully justified as a matter of sound public policy and urge its adoption.

Retirement plans in the college and university community have evolved over many years in response to differing needs, and in the past we have had very simple plans put in place largely through one major providing organization, the Teachers Insurance Annuity Association and College Retirement Equities Fund. It has been very simple for colleges and universities to put these plans in place. And in contrast with the previous testimony from small business, the vast majority of colleges and universities do have retirement plans for both faculty and the staff that supports the academic reaearch and teaching mission.

As we look to the future, we see a transition that is moving on us and that is requiring much more compliance with regulation than we have ever seen before.

Why do we want more time? Well, in the Tax Reform Act, Congress asked the Treasury to prescribe regulations relating to these nondiscrimination requirements no later than February of 1988. The regulations haven't been proposed, much less adopted in final form. This rulemaking is delayed for 403(b), the type of plans we have, because rulemaking for general plans, the so-called "qualified

plans," is under serious consideration, and it looks as though it will be impossible for Treasury to prescribe these specific rules in time. We simply do not know when guidance will be forthcoming.

Once the guidance is provided, affected institutions are going to need time to evaluate whether their present plans are in compliance.

Now, for many of our institutions we have a problem of comparability where, for certain classes of faculty, we have defined-contribution plans, and we have defined-benefit plans for those who support the academic mission.

Comparability is a very, very complex issue, and these rules, too, are slated for revision; but they won't be slated for that revision until such time as the earlier regulations come into place.

So, the burden here falls unduly on our smaller colleges and universities. Organizations like my organization, using actuaries, consultants, attorneys and so forth, can do these things we think in a way that would comply with regulations yet to be issued. But there is a fairness concern here for the numerous smaller institutions, that it isn't realistic or it isn't fair to expect compliance by 1989.

And there is an economic issue here: Compliance should be done on the fairest, lowest cost, most cost-effective way. And what we really are asking for is give us time to know the legal requirements, give us an opportunity to weigh the alternatives, so that we come up with the most favorable solutions.

Thank you so much.

[Mr. Wilson's prepared statement follows:]

STATEMENT OF ROBERT M. WILSON

ON BEHALF OF

THE AMERICAN COUNCIL ON EDUCATION

Mr. Chairman, my name is Robert M. Wilson. I am the Vice President for Personnel Programs at Johns Hopkins University in Baltimore, Maryland. I also serve as Chairman of the National Benefits Council of the College and University Personnel Association and on committees of the National Association of College and University Business Officers and the Consortium on Financing Higher Education. I appear before you today on behalf of the American Council on Education, an association representing more than fifteen hundred colleges, universities, and other organizations involved in higher education, and the other associations listed on the cover sheet of this statement. I appreciate the opportunity to appear before this Subcommittee to discuss an issue of major importance to higher education.

The Tax Reform Act of 1986 fundamentally altered the rules governing the retirement plans of colleges and universities by extending the nondiscrimination rules applicable to qualified pension plans to retirement plans established under section 403(b) of the Internal Revenue Code. Such rules are scheduled to become applicable to section 403(b) plans in 1989. Section 4 of the Small Business Retirement and Benefit Extension Act would delay the imposition of those rules until two years after the issuance of final regulations. We believe that the postponement of the effective date is fully justified as a matter of sound public policy and urge that it be adopted.

The retirement plans of colleges and universities have evolved over the years in response to the differing needs and career patterns of faculty, administrative, and other personnel. Retirement plans for faculty and administrative personnel have customarily been established under section 403(b) of the Code. Because nondiscrimination rules have never applied to section 403(b) programs, colleges and universities have not taken such rules into account in the design of compensation packages for various groups of employees. Thus, for example, it has been

possible for the overall compensation of faculty members to consist of a lower proportion of salary and a higher proportion of retirement plan contributions than that of other employees. The fact that different employees may receive differing proportions of salary and retirement benefits is not intrinsically unfair; however, since that form of disparity bears the label of "discrimination," it will be prohibited when the new rules become effective.

My purpose is not to argue the merits of applying non-discrimination rules to section 403(b) retirement plans. Congress has already made that policy decision, and colleges, universities, and other affected institutions must focus their attention on its implementation. However, in order to appreciate the nature of the transition that must occur, I think it is important to be mindful of the legal regime under which college and university retirement plans have been structured and benefit commitments have been made. In order for the transition to the new regime to occur with minimal disruption, institutions must have adequate time to understand their new obligations, evaluate their alternatives, and to implement the changes that are necessary to achieve compliance. It is for this reason that we believe section 4 of the bill should be adopted.

Since Congress initially delayed the effective date of the nondiscrimination rules for more than two years, it is fair to ask why additional time is needed. The most important reason for postponement is that the applicable rules have yet to be formulated, except in skeletal form. As part of the Tax Reform Act, Congress directed Treasury to prescribe regulations relating to nondiscrimination requirements for section 403(b) plans no later than February 1, 1988, less than four months from today. These regulations have not yet been proposed, much less adopted in final form. Pending the adoption of regulations, there are a number of important questions which remain unanswered and which are crucial to compliance by affected institutions. For example,

it is essential for institutions to know how benefits accrued prior to the effective date of the nondiscrimination rules will be taken into account, if at all, thereafter. In addition, the Tax Reform Act made very significant changes in the substance of the nondiscrimination rules that will now apply to section 403(b) plans. These changes, which relate to such matters as minimum coverage and social security integration, have yet to be clarified in regulations or rulings. Since these changes apply to a much larger universe of plans, it may be impossible for the Treasury to prescribe specific rules for section 403(b) plans until work on the other changes in the nondiscrimination rules has been completed. In any case, institutions cannot make specific changes to their retirement plans until much more detailed regulatory guidance is provided; as of today, we do not know when that guidance will be forthcoming.

Once the regulatory guidance is provided, affected institutions will need a meaningful period of time to evaluate whether their existing retirement plans are in compliance. In many instances, the extent of any disparity in relative benefits among different groups of employees cannot be determined without extensive actuarial analysis of data relating to the age, salaries, years of service, and projected benefits of all employees. This analysis must be based on standards set forth by the Internal Revenue Service, and those standards, too, have been slated for revision. This form of actuarial analysis, referred to as "comparability" testing, represents a formidable administrative burden. In imposing nondiscrimination requirements on section 403(b) plans, Congress directed the Treasury to prescribe rules that will reduce that administrative burden. However, since such rules have yet to be prescribed, we do not know the nature of the relief that will be provided.

It is important to bear in mind that there are hundreds of small institutions for which this process will be especially onerous. The simplicity of the rules that have existed under section 403(b) prior to last year's tax Act has enabled these institutions to maintain retirement plans without retaining

actuaries, benefit consultants, and lawyers. It is safe to say that many of these institutions have only a vague awareness that their retirement plans may need to be redesigned. Assuming that regulatory guidance is provided in 1988, it will be very difficult, even for large institutions with knowledgeable professional staffs and established relationships with outside advisors, to implement required changes by 1989. For the numerous smaller institutions, it is simply not realistic or fair to expect that the process can be completed by 1989.

For those institutions, whether large or small, that will be compelled to modify their retirement plans, there will be no simple or attractive recipe for achieving compliance. If a prohibited disparity in benefit levels exists, it may be remedied only by reducing the benefits of one group of employees, increasing the benefits of another group, or by some combination of those two approaches. The first approach will inevitably have adverse repercussions from the standpoint of employee relations since employees have legitimately come to rely upon the retirement plan contributions that have traditionally been made. The alternative of increasing benefits for lower paid employees has significant budgetary implications. In any case, affected institutions will want to implement any changes to existing benefit structures with confidence that they have not done too little or too much. To do this, they will need full knowledge of the applicable legal requirements and a reasonable opportunity to weigh the alternatives. For these reasons, a further delay in the effective date of the nondiscrimination rules is warranted.

Thank you for the opportunity to express these views.

Senator PRYOR. Mr. Wilson, thank you. We appreciate your statement.

I know that last year we heard many hundreds and perhaps thousands of people that you speak for. I don't know what the mechanism is that you turned on, but somehow I know that you pressed the right button, because a lot of letters and telegrams and positions came to this committee during the markup of that bill. We appreciate it, and we appreciate you coming and representing that group of individuals so well this morning.

Mr. Joe Heusi.

STATEMENT OF JOE HEUSI, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE VARIABLE ANNUITY LIFE INSURANCE COMPANY, HOUSTON, TX

Mr. HEUSI. Thank you, Mr. Chairman.

My name is Joe D. Heusi. I am the president and chief executive officer of the Variable Annuity Life Insurance Co., commonly known by its acronym VALIC, headquartered in Houston, TX.

VALIC is one of the country's leading providers of 403(b) annuities for educational and charitable institutions. During my 20-year career I have seen those programs work effectively. While we are in general support of all provisions of the bill, I will limit my testimony to only those provisions which are affected under 403(b).

The pending bill would modify three changes to section 403(b) made by the Tax Reform Act:

First, the bill would repeal the rule which generally prohibits employees from receiving in-service distribution under a section 403(b) contract prior to age 59½.

Second, while retaining the newly-enacted $9,500 annual limit, it would, commencing in 1988, allow for cost-of-living adjustments in that.

And last, certainly not least, as Mr. Wilson has said, the bill would effectively postpone the implementation of nondiscriminatory rules until such time as the Treasury has given notice as to what they will be for a 2-year period after that.

First, on the prohibition to withdrawals, unless repealed before it becomes effective in 1989, new section 403(b)(12) will prohibit withdrawals of amounts attributable to section 403(b) salary reduction contributions prior to the separation from service, attainment of age 59½, death, disability, or hardship.

The case for repeal of these withdrawal restrictions we feel is quite compelling. In light of the newly-enacted 10-percent penalty on distributions received before age 59½, which would not be altered by this bill, the withdrawal restrictions are redundant and will not significantly advance any policy objective. The restrictions will, however, impose significant recordkeeping and other administrative burdens on life insurance companies, employers, create time-consuming interpretive problems for the IRS, Treasury, and the Securities and Exchange Commission, encourage evasive behavior on the part of taxpayers who wish to make withdrawals, and inhibit voluntary retirement savings by those who fear they may be denied access to their money before separation from service—or, to put it another way, the imposition of these hardship rules is sending, we believe, the signal that this committee does not intend

to send; that is, it is discouraging them rather than encouraging them. We feel, therefore, it should be enacted.

I want to hasten to add that we do not encourage employees to take monies out of our annuities. Frankly, that is counterproductive to our business mission and would cost the company significant revenues.

There have, however, been, since 403(b) annuities were introduced, significant incentives for the people to leave their money there. With a 10-percent penalty tax, I don't think you need any more.

It is clearly appropriate, on the $9,500 limit, that it should be adjusted for changes in the cost of living. While contributions for the great majority of 403(b) participants do not exceed $9,500, certainly in the early part of their careers, it is very likely and historically very true that toward the end of their careers many of these employees have chosen to participate at levels of $9,500 or greater.

It may very well be the fact that there is not a fundamental understanding of how expensive pensions are and how much money must be put away. In my testimony there are some figures; I will briefly refer to them:

By taking a $3,000 annual contribution at the age of 40, assuming retirement at 65, if the person did not start contributing until 55 it would take an annual contribution in excess of $9,500 to get the same benefit. And as we well know, expenses do tend to drop as you get later on in your earning years.

I think that the important thing to remember is that, prior to TRA 1986, there were some catch-up rules which allowed people to exceed the basic limitations. There was recognition in the Tax Reform Act of that need, and in fact there was a provision put in.

However, the special rule in the Tax Reform Act is so complicated that, just for one example, you have to have 15 years of service with the same employer before you can take advantage of it. If you would index the $9,500, this would solve the problem without adding tremendously to the burden.

I think I can say nothing more eloquent than Bob has said about the nondiscrimination rules.

Thank you.

[Mr. Heusi's prepared statement follows:]

STATEMENT OF JOE D. HEUSI, PRESIDENT,
THE VARIABLE ANNUITY LIFE INSURANCE COMPANY

Mr. Chairman, my name is Joe D. Heusi. I am the President of The Variable Annuity Life Insurance Company ("VALIC") which has its home office in Houston, Texas. I welcome the opportunity to appear before this Subcommittee to testify in support of the Small Business Retirement and Benefit Extension Act (S. 1426).

VALIC is one of the country's leading providers of annuities purchased under section 403(b) of the Internal Revenue Code for employees of educational and charitable institutions. I have worked with and for these individuals for over twenty years, first as a public school teacher myself, then as a registered representative who dealt on a daily basis with educators and employees of charitable institutions who were seeking to save for retirement, and finally in my present capacity. During that period, I have seen that section 403(b), in its simplicity and flexibility, has effectively served the special needs of educational and charitable employees with minimal administrative burdens for the institutions that employ them.

While we support all provisions of the bill that will foster enhanced retirement plans for employees of small businesses and nonprofit organizations, I will limit my testimony to those provisions relating to annuity purchase programs under section 403(b). As the Chairman stated in his introductory remarks for this bill, certain changes in this area were made "in haste" as part of the Tax Reform Act of 1986. In particular, we are concerned about the administrative burdens that certain of those changes will impose on employers and life insurance companies and the effect that the changes will have on the ability of middle-income employees in the educational and charitable sectors to provide for their financial security after retirement.

The pending bill would modify three changes to section 403(b) made by the Tax Reform Act. First, the bill would repeal the rule which would generally prohibit employees from receiving

in-service distributions under section 403(b) contracts prior to age 59½. Second, while retaining the newly-enacted $9,500 annual level on salary reduction contributions, the bill would allow that limit to be adjusted, commencing in 1988, for changes in the cost of living commencing in 1988. Third, the bill would delay the effective date of the newly-enacted nondiscriminatory rules for section 403(b) programs until two years after the promulgation of final regulations. We support all of these changes.

PROHIBITION ON WITHDRAWALS

Unless repealed before it becomes effective in 1989, new section 403(b)(12) will prohibit withdrawals of amounts attributable to section 403(b) salary reduction contributions prior to separation from service, attainment of age 59½, death, disability, or hardship (the amount distributable on hardship would exclude earnings on contributions).

The case for repeal of the withdrawal restrictions is compelling. In light of the newly enacted 10 percent penalty tax on distributions received before age 59½, which would not be altered by the bill, the withdrawal restrictions are redundant and will not significantly advance any policy objective. The restrictions will, however, impose significant recordkeeping and other administrative burdens on life insurance companies and employers, create time-consuming interpretive problems for the IRS, Treasury, and the Securities and Exchange Commission, encourage evasive behavior on the part of taxpayers who wish to make withdrawals, and inhibit voluntary retirement savings by those who fear that they may be denied access to their money before separation from service.

The stated reason for the withdrawal restrictions is that the federal tax system should not subsidize retirement savings programs to the extent that moneys are diverted to nonretirement uses. H.R. Rep. No. 99-426, 99th Cong., 1st Sess. 728 (1985). In fact, the continued availability of in-service withdrawals will not result in any federal tax subsidy at all. On

the contrary, to the extent that individuals actually make withdrawals that would otherwise be prohibited, our data shows that the present value of total tax payments (regular tax and the 10 percent penalty tax) will exceed the taxes that would have been payable if no section 403(b) contribution had been made. An individual in the 15 percent tax bracket must participate in a section 403(b) program for approximately 18 years before the value of tax deferral (as opposed to investing with after-tax dollars) exceeds the additional cost of the 10 percent penalty tax; for an individual in the 28 percent tax bracket, the break-even point is approximately 12 years of participation. Our data on the pattern of withdrawals under section 403(b) programs shows that approximately 80 percent of those making withdrawals before age 59½ have participated for 5 years or less, and 95 percent have participated for 9 years or less.

Based on this data, not only will the Government come out ahead by continuing to allow in-service withdrawals under section 403(b) programs, but in the typical case the Government will come out far ahead. In the absence of adverse revenue implications, it is difficult to see that the Government has any other stake in maintaining the restrictions. The restrictions only apply to contributions that employees have voluntarily made out of their own salaries, not amounts that their employers contributed to a retirement plan or that are required to be contributed to satisfy any requirement under the Internal Revenue Code.

Let me hasten to add that we do not encourage employees to withdraw their section 403(b) contributions for nonretirement purposes. Indeed, since my company profits from the retention of assets, its profitability would be impaired if the magnitude of withdrawals were great. However, we do not believe the withdrawal restrictions are necessary to prevent that from occurring. There has always been a financial incentive for employees to allow their savings to accumulate on a tax-deferred basis until retirement, and the 10 percent penalty tax now makes that incentive significantly stronger.

Any marginal reduction in the rate of withdrawals resulting from the restrictions will be far outweighed by the administrative burdens, complexities, and other problems it will create. From the standpoint of life insurance companies issuing such contracts, it will become necessary to segregate salary reduction contributions from employer contributions because the latter will not be subject to the withdrawal restrictions, and to further segregate the amount of salary reduction contributions from the earnings thereon because the latter will not be distributable in cases of hardship. In addition, it will be necessary to maintain permanent records of the amount of each employee's accumulated contributions on December 31, 1988, because such amounts will be exempt from the withdrawal restrictions. Assuming we are able to maintain such records, it will then be necessary to ascertain whether an individual who requests a withdrawal has separated from service with the employer, incurred a hardship, or is otherwise eligible to make such a withdrawal. Since it is generally impossible for life insurance companies to verify such matters, the restrictions will be subject to circumvention by those intent on receiving withdrawals.

The withdrawal restrictions will also place unnecessary burdens on the Government. For example, the Internal Revenue Service and the Treasury will need to promulgate rules relating to the effect of the withdrawal restrictions where an employee has made a rollover or wishes to exchange a section 403(b) annuity contract for a contract issued by another company. Moreover, it will be necessary for the Securities and Exchange Commission to determine whether variable annuity contracts purchased under section 403(b) will be exempted from the right of redemption provided under the Investment Company Act of 1940; if such exemptive relief is not granted, employees will be precluded from purchasing variable annuities under section 403(b) programs.

Finally, and perhaps most importantly, we are concerned about the inhibiting effect that the withdrawal restrictions will have on those nonhighly compensated employees who want to save for retirement, but are uncertain whether they can afford to do so.

The availability of withdrawals is generally a nonissue for the highly compensated. Our own data shows that approximately 97 percent of those who have actually made withdrawals have annual salaries of $45,000 or less. For such middle-income employees, the threshold decision to save for retirement is often very difficult. Even if they do not foresee making a withdrawal prior to retirement, the knowledge that their money will be available if needed can be a key element in their decision to participate.

Congress has repeatedly stressed the importance of broad-based participation in retirement and other benefit programs. Until now, section 403(b) has been broadly utilized by eligible employees at all compensation levels. We are concerned that the new 10 percent penalty tax, standing by itself, may have a dampening effect on voluntary participation in section 403(b) programs by nonhighly compensated employees. So far, this has not proven to be the case. However, if the withdrawal restrictions are allowed to take effect, the combined impact of the penalty tax and the withdrawal restrictions may well lead to a sharp drop in voluntary section 403(b) participation by middle and lower income employees. Since there is no significant reason to maintain the restrictions, we do not think that risk is worth taking.

INDEXING OF $9,500 LIMIT

Under new section 402(g)(4) of the Code, the annual limit on salary reduction contributions under section 403(b) is $9,500. Although the parallel limit for elective deferrals under section 401(k) plans will be adjusted, commencing in 1988, for increases in the cost-of-living, the Code does not presently provide for indexing of the separate section 403(b) limit. The bill would index the $9,500 limit in the same manner that the section 401(k) limit is indexed.

It is clearly appropriate that the $9,500 limit be adjusted for changes in the cost-of-living. While the contributions of the great majority of section 403(b) participants are lower than $9,500 during the early parts of their careers, it is very common for older participants to make annual contributions

at that level. At later ages, such contributions provide relatively modest amounts of retirement income. For example, a $9,500 contribution by a 55-year old could be expected to provide a life annuity at age 65 of about $2,500, which is approximately the same amount that would be provided by a $3,000 contribution by a 40-year old. If the $9,500 limit is not indexed, the ability of those individuals to produce reasonable levels of retirement income will be significantly eroded by increases in the cost-of-living. The Tax Reform Act recognized the legitimate needs of older section 403(b) participants to make "catch-up" contributions in excess of $9,500. However, the special rule, which allows annual contributions as high as $12,500, is so riddled with conditions (e.g., at least 15 years of service with the current employer) that it benefits only a tiny fraction of section 403(b) participants. In lieu of liberalizing the restrictions on such catch-up contributions, indexing of the $9,500 limit will provide an appropriate measure of relief.

EFFECTIVE DATE FOR NONDISCRIMINATION RULES

Under the Tax Reform Act, employer-funded section 403(b) retirement programs will become subject to essentially the same nondiscrimination rules that apply to private sector qualified plans, commencing in 1989. The bill would delay the effective date of those rules to years beginning at least two years after the promulgation of final regulations. We fully support this postponement to avoid what will otherwise be a very chaotic transition.

Colleges and universities, as well as certain other charitable institutions, have traditionally maintained employer-funded retirement programs under section 403(b). These plans have been structured and benefit commitments have been made to existing personnel without the constraint of nondiscrimination rules, for such has been the law for 45 years. Thus, for example, a college or university has been authorized to maintain a section 403(b) plan for its faculty members and to maintain a separate plan for other personnel, which may or may not provide retirement benefits

proportionate to those projected under the faculty plan. The basic effect of the nondiscrimination rules will be to require that proportionate benefits be provided under such plans.

The bill does not address the merits of imposing nondiscriminatory requirements on section 403(b) programs, but it addresses a problem that is almost equally important -- how compliance with the nondiscrimination rules is to be implemented. The rules in this area are unusually complex and in the absence of detailed actuarial analysis, it will generally be impossible for an institution to know whether and to what extent its benefit structure must be changed. Moreover, regulations providing guidance on exactly how the rules will be applied to section 403(b) programs have not yet been adopted. Once such regulations are adopted, institutions will need substantial time to evaluate their existing benefit structures, weigh alternatives, consider the budgetary impact of the alternatives, gain approvals from their governing bodies of any changes that may be required, and to provide advance notice of the changes to affected employees. It is plainly not realistic to expect institutions to make these changes by 1989. The postponement provided under the bill is entirely reasonable.

CONCLUSION

For the foregoing reasons, we urge that the provisions of the Small Business Retirement and Benefit Extension Act relating to section 403(b) be adopted.

Senator PRYOR. Thank you, Mr. Heusi. You have come a long way to have your 5 minutes, and we appreciate that very much.

Mr. Vince Robison.

First, before you start, there is a rumor floating around among some of our staff personnel that you may be from Arkansas. Is that right? Were you born in Arkansas?

Mr. ROBISON. Senator Pryor, I was born in Conway County, AR.

Senator PRYOR. I thought I knew everyone in Arkansas that had ever been born there.

Mr. ROBISON. I am sure we could share some stories, Senator. I would like to do that.

Senator PRYOR. Thank you. That is a pleasant surprise. I did not know that. Thank you very much for coming.

STATEMENT OF VINCE ROBISON, CAE, CHAIRMAN OF THE BOARD, AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES, WASHINGTON, DC

Mr. ROBISON. Thank you, Mr. Chairman.

I am Vince Robison, president of the Associated Motor Carriers of Oklahoma, located in Oklahoma City, and currently chairman of the board of the American Society of Association Executives here in Washington, DC.

The American Society of Association Executives is pleased to have the opportunity to present testimony on the Small Business Retirement and Benefit Extension Act.

ASAE is a professional society of 15,600 association executives across America who represent more than 80 million Americans in this country. Most of ASAE's members work for associations which employ less than 100 employees. ASAE members represent tax-exempt organizations under sections 501(c)(6), 501(c)(3), and other similar sections of the Code.

Many of our member associations currently sponsor or are contemplating sponsoring some form of qualified retirement plan, including cash or deferred arrangements.

ASAE supports the Small Business Retirement Act, and in particular the provision in the act that extends tax-sheltered annuities under section 403(b) of the Code to all nongovernmental tax-exempt organizations.

Organizations that are exempt under section 501(c)(3) already have access to tax-sheltered annuities. For-profit employers may offer their employees 401(k) plans, and Federal Government employees were recently granted access to tax-deductible salary-reduction retirement programs.

Employees of 501(c)(6) trade associations, on the other hand, are precluded from such participation. There seems to be no logical reason or justification for that discrepancy. So, the situation as it currently stands is grossly unfair and should be rectified, and this provision in this Act does that.

ASAE is also interested in the elimination of top-heavy rules. The limited benefits derived under the top-heavy rules after the Tax Reform Act simply no longer justify the administrative burdens that are imposed by these rules on employers of our members.

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Some still believe that private-sector tax-exempt employers may offer their employees tax-sheltered annuities. In fact, this is only true for private-sector tax-exempt employers exempt from taxation under section 501(c)(3), and employees of trade associations and professional societies exempt from taxation under section 501(c)(6) do not have access to 403(b) plans.

Congress has brought section 457 of the Code to a select group of management or highly-compensated employees. Those who argue in favor of denying access to 401(k) plans to employees of tax-exempt organizations assumed that 401(k) plans and 457 plans are equivalent vehicles for retirement savings. That premise is inaccurate.

First, an unfunded arrangement in the private sector does not offer adequate retirement income security.

Second, under current law, section 457 restricts participation in these plans to highly-compensated employees or a select group of management employees.

ASAE is not suggesting that an exemption from the funding rules be granted. We would not want unfunded plans to be extended to all employees, because deferred amounts would be subject to the creditors of the employer.

Mr. Chairman, our members are particularly sensitive to the tax incentive for employee benefits, because these incentives affect the ability of ASAE member associations to attract well-qualified personnel. We have to compete in the same labor pool for employees as do private industries and as does the Federal Government.

Another area of our concern lies with the top-heavy rules applicable to qualified retirement plans. We would extend our statement in the record and would file that with you.

In conclusion, I will say that employees of 501(c)(6) trade associations need equitable treatment, and we believe that repeal of the top-heavy rule is in the best interest of associations because these rules, since the passage of the Tax Reform Act, no longer justify the administrative burdens they impose.

[Mr. Robison's prepared statement follows:]

WRITTEN STATEMENT OF VINCE ROBISON
CHAIRMAN OF THE BOARD OF THE
AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

INTRODUCTION

Mr. Chairman, my name is Vince Robison. I am the President of Associated Motor Carriers of Oklahoma, Inc., located in Oklahoma City, Oklahoma, and Chairman of the Board of the American Society of Association Executives.

The American Society of Association Executives ("ASAE") is pleased to have the opportunity to present a written statement for the printed record of the October 23, 1987 hearing of the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service of the Committee on Finance, U.S. Senate, on the Small Business Retirement and Benefit Extension Act (the "Small Business Retirement Act") announced in Press Release No. H-65 issued on October 14, 1987.

ASAE supports the Small Business Retirement Act. The provision in the Act which interests ASAE the most is the extension of tax-sheltered annuities under Section 403(b) of the Internal Revenue Code ("Code") to all non-governmental tax-exempt organizations. As this Subcommittee is aware, organizations exempt under Section 501(c)(3) of the Code already have access to tax-sheltered annuities. For-profit employers may offer their employees 401(k) plans. And, Federal government employees were recently granted access to tax deductible salary reduction retirement savings programs. It is unfair that employees of tax-exempt organizations other than 501(c)(3)'s are precluded from supplementing their private savings for retirement through tax-favored savings. This is particularly true because many of ASAE's members can no longer make tax-deductible contributions to Individual Retirement Accounts ("IRA's") after the Tax Reform Act of 1986.

ASAE also is interested in the elimination of the top-heavy rules. ASAE believes that the limited benefits derived under the top-heavy rules after the Tax Reform Act of 1986 no longer justify the administrative burdens imposed by the top-heavy rules on the employers of our members.

ASAE's written comments will be directed only at the proposals in the Small Business Retirement Act regarding cash or deferred arrangements ("CODA's") (and why Section 457 Plans are not adequate replacements for CODA's) and top-heavy plans (and why the top-heavy rules should not apply to plans sponsored by tax-exempt organizations).

ASAE is headquartered at 1575 Eye Street, N.W., Washington, D.C. 20005 (202-626-2703) and is the professional society for executives who manage trade and professional associations as well as other not-for-profit voluntary organizations in the United States and abroad. Founded in 1920 as the American Trade Association Executives with 67 charter members, ASAE now has a membership of over 15,600 individuals representing more than 7,000 national, state, and local associations. In turn, these business, professional, educational, technical and industrial associations represent an underlying force of more than 80 million people throughout the world. Many of ASAE's members work for associations which employ less than 100 employees. The overwhelming majority of ASAE's members represent tax-exempt organizations, most of which are either tax-exempt as trade associations under Section 501(c)(6) of the Code or tax-exempt as educational or charitable organizations under Section 501(c)(3) of the Code. Many of ASAE's member associations either sponsor or are contemplating sponsoring some form of qualified retirement plan, including CODA's, also known as 401(k) plans. Please see Appendix A for results of a survey conducted by ASAE concerning the nature of retirement benefits offered by associations. As a result, ASAE is an interested party to legislative activity in this area.

A recent report issued by the Employee Benefit Research Institute entitled, The Changing Profile of Pensions, has reaffirmed the common wisdom that retirement income should generally consist of three parts: (1) Social

Security benefit payments, (2) private retirement plan benefit payments and (3) private savings. It is unfair that employees of private sector tax-exempt organizations other than organizations exempt under 501(c)(3) of the Code can not supplement their private savings for retirement through tax-favored savings. Given the changes to the rules governing IRA's enacted by the Tax Reform Act of 1986, no tax-deductible savings vehicle may be available to employees of these organizations.

Congress, in the Tax Reform Act of 1986, acted to prohibit all tax-exempt organizations from adopting 401(k) plans after July 1, 1986. ASAE was active in the unsuccessful attempt to preserve new 401(k) plans for non-governmental tax-exempt organizations during the development and passage of the Tax Reform Act of 1986. Congress also brought under Section 457 of the Code unfunded salary reduction arrangements ("457 plans") offered by private sector tax-exempt organizations to a select group of management or highly compensated employees. The only type of non-governmental tax-exempt organization that can provide tax-favored salary reduction savings on a funded basis to its employees are organizations that are tax-exempt under Section 501(c)(3) of the Code. As stated earlier, employees of those organizations have available to them tax-sheltered annuities under Section 403(b) of the Code.

The first serious proposals for change in these areas can be found in "The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity" ("President's Proposal") (1985). The President's Proposal contained certain provisions regarding retirement plans that uniquely applied to private sector tax-exempt organizations and public sector employers. First, the President proposed that private sector tax-exempt organizations and public sector employers no longer be permitted to establish and maintain CODA's. Second, the President proposed to establish a set of rules for deferred compensation arrangements of private sector tax-exempt organizations that would be similar to the rules applicable to public sector employers. The rules for public sector employers are found in Section 457 of the Code. Arrangements conforming to these rules now appear to be the exclusive method for providing salary reduction unfunded deferred compensation arrangements for private sector tax-exempt employers. Both of these proposals were adopted in the Tax Reform Act of 1986. The combined impact of the adoption of these proposals was to reduce the ability of an employee of a private sector tax-exempt organization to save for his or her retirement on a tax-favored basis.

Although the President's Proposal was supplanted by the passage of the Tax Reform Act of 1986 and its legislative history, it continues to be an effective tool for analyzing the tax policy considerations underlying the changes brought about in these two areas by the Tax Reform Act. The reasoning employed by the drafters of the President's Proposal was employed by the supporters of these changes time after time throughout the legislative process.

403(b) PLANS

In the explanation of reasons for change, the President's Proposal stated that private sector tax-exempt employers may offer their employees tax-sheltered annuities. ASAE is concerned that some members of Congress and their staff may still believe this to be the case. In fact, this is only true for private sector tax-exempt employers exempt from taxation under Section 501(c)(3). Employees of associations exempt from taxation under Section 501(c)(6) and other private sector tax-exempt employers not exempt under Section 501(c)(3) do not have access to 403(b) plans.

As stated above, ASAE actively sought to retain 401(k) plans for private sector tax-exempt organizations during consideration of the Tax Reform Act of 1986. Although ASAE continues to believe that 401(k) plans are preferable in many ways to 403(b) plans, it is willing to accept the fact that 401(k) plans have been declared off-limits to private sector tax-exempt organizations and look to other alternatives. Salary reduction plans established under Section 403(b) represent one such alternative. These plans permit contributions by either the employer, the employee, or both. To the extent the amounts con-

tributed do not exceed the legislatively-prescribed ceiling, the employee is not currently taxed on contributions to the plans. Finally, the amounts contributed can be used either to purchase an annuity contract or to invest in mutual funds.

One advantage of 403(b) plans is that assets held in a 403(b) plan are easily transferable from employer-to-employer. This is important to ASAE's members, many of whom frequently transfer employment between academia and associations and from association to association. Although the decision to support legislation which makes 403(b) plans available to private sector tax-exempt organizations was not primarily motivated by these factors, there are several other advantages to offering a 403(b) plan over a 401(k) plan. Two of the advantages are that the discrimination tests applicable to the salary reduction feature are more flexible for 403(b) plans and the salary reduction limit of $9,500 is higher than the $7,000 limit imposed on 401(k) plans. There are also certain advantages to 401(k) plans. One advantage is that they are more familiar to employees formerly associated with private sector for-profit organizations. Another is that the range of investment vehicles available to 401(k) plans is much broader than that which is available to 403(b) plans. Finally, the coordination with other retirement programs is easier for 401(k) plans than 403(b) plans.

The denial of access to 401(k) plans to employees of tax-exempt organizations assumes that 401(k) plans and unfunded deferred compensation plans ("457 plans") are equivalent vehicles for retirement savings. This premise is inaccurate for two reasons. The first reason is that an unfunded arrangement in the private sector does not offer adequate retirement income security. The second reason is that under current law Section 457 restricts participation in these plans to highly compensated employees or a select group of management employees.

Turning now to the first area of concern, Section 457 plans have to be unfunded. Therefore, deferrals by employees are subject to the general creditors of the private sector tax-exempt employer rather than being set aside in an arrangement that would be safe from the general creditors of the employer. This defect greatly reduces the retirement security of an employee because of the uncertainty whether his employer will be financially able to satisfy its obligations. This concern for fiscal well-being is enhanced because private sector tax-exempt organizations, unlike public sector government entities, do not have the ability to levy taxes to raise revenue. Thus, by eliminating 401(k) plans for private sector tax-exempt employers, employees of tax-exempt organizations not exempt under Section 501(c)(3) of the Code have not been treated equally with employees of public sector or private sector for-profit employers.

The second problem is that 457 plans of private sector tax-exempt employers cannot be offered to all employees because 457 plans are not excluded from the funding provisions of the Employee Retirement Income Security act of 1974 ("ERISA") administered by the U.S. Department of Labor. These ERISA provisions require 457 plans maintained by private sector employers to be funded if they are made available to employees who are not highly compensated or a member of a select group of management. The Internal Revenue Code, on the other hand, requires these plans to be unfunded. The drafters of ERISA were concerned that most employees do not have the information about the employer or the bargaining position with the employer to be subjected to the financial risk of unfunded deferred compensation. Absent a specific exemption from the application of Title I of ERISA, as a practical matter, plan participation may need to be limited to highly compensated employees or a select group of management employees, thereby creating an additional disparity between public and private sector employees. ASAE is not suggesting that an exemption from the funding rules be granted. ASAE does not want unfunded plans to be extended to all employees because deferred amounts would be subject to creditors of the employer.

ASAE's members are particularly sensitive to the tax incentives for employee benefits, like funded salary reduction plans, because these incentives affect the ability of the employers of ASAE members to attract well-qualified personnel. Trade associations frequently compete within the same

labor pool for employees as private industries that have 401(k) plans or organizations that have tax-sheltered annuities available to them. Not only must trade associations be competitive in relation to these employers, but they must also compete with the Federal government which now provides a salary reduction plan for Federal employees. Furthermore, it appears that 457 plans offered by public sector employers work reasonably well in the governmental sector because public entities generally have the power to tax to secure the promise. Because most of our members work for associations that are small tax-exempt employers, they are concerned about tax incentives that favor for-profit employers or other segments of tax-exempt organizations, or that create tax disadvantages for small tax-exempt employers. These disparities create an often insurmountable handicap to attracting and keeping qualified employees. It is also unfair that our members have to do their savings for retirement on a different basis than the employees of virtually every other type of employer.

ASAE strongly urges Congress to adopt the Small Business Retirement Act. Section 4(c) of this Act will allow all tax-exempt employers the opportunity to offer salary reduction programs in the form of tax-sheltered annuities to their employees. ASAE understands that the revenue impact of permitting private sector tax-exempt employers to continue to maintain 401(k) plans for their employees is minimal. It is assumed that the same will hold true if 403(b) plans are permitted to be maintained. However, ASAE has not seen any governmental cost estimates for this change.

TOP-HEAVY PLANS

The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), contains numerous retirement provisions, many of which were not debated in Congress but were introduced at the last minute in conference. ASAE is concerned about the qualified retirement plan provision that introduced a new concept called top-heavy plans. These changes adversely impact many of ASAE's members and their employers by increasing the cost of establishing and maintaining qualified retirement plans.

Tax-exempt associations should be exempted from complying with the top-heavy provisions of TEFRA because compliance would burden tax-exempt associations with unnecessary government regulation. The Small Business Retirement Act would accomplish this goal by eliminating top-heavy requirements for everyone. Many employers of ASAE members sponsor retirement plans which either are not subject to the top-heavy minimum standards because they do not meet the top-heavy concentration test or because they already comply with those minimum standards. Also, in 1989, virtually all of the top-heavy minimum standards will have been incorporated in the law for all plans. Nevertheless, the fiduciaries or administrators of these plans must determine who is a key employee based on the individual's job description and duties and five years of plan data, whether or not the plan is top-heavy.

A plan is top-heavy if more than 60% of the retirement benefits under the plan are for the benefit of key employees. The definition of a key employee in a tax-exempt association is limited to an officer because tax-exempt associations do not have owners. Determining who is an "officer" in an association is especially difficult because most associations have volunteers who perform many of the duties often performed by both officers and staff employees. The top-heavy test must be applied annually to a rolling five-year data base.

Again, ASAE strongly urges Congress to adopt the Small Business Retirement Act. Section 2 of this Act repeals the special restrictions which apply to top-heavy plans for all employers effective January 1, 1988.

CONCLUSION

As a representative of employees of tax-exempt associations, ASAE is most concerned with the tax incentives provided at the employee level for promoting retirement savings. ASAE believes that employees of private sector tax-exempt associations need the flexibility that salary reduction arrangements provide for an individual to save for adequate retirement income. ASAE believes that repeal of the top-heavy rules is in the best interests of its member associations and their employees because the limited benefits afforded by these rules since the passage of the Tax Reform Act no longer justify the administrative burdens they impose.

APPENDIX A

The accompanying table was extracted from "1987 Association Executives Compensation Study" published by ASAE. It reports data on association retirement benefits compiled through use of a survey mailed to each of the approximately 6,600 associations represented in ASAE. Over 2,100 surveys were returned reflecting a 32% response rate. Of these, 2,088 were used in compiling the data. As the following chart reveals, the survey participants' demographics correspond closely to those of the ASAE membership as a whole.

	ASAE Membership as of Feb. 1987	1987 AECS Survey Participants
Type:		
Individual	47%	41%
Trade	53%	59%
Scope:		
International/National	41%	42%
State/Regional	42%	42%
Local	17%	16%
Budget:		
Less than $500,000	37%	41%
$500,000–$999,999	25%	20%
$1–$5 million	27%	29%
Over $5 million	11%	10%
Staff		
1–10	65%	63%
11–20	15%	15%
21–50	12%	11%
51–100	5%	6%
Over 100	3%	5%
Geographic Region		
New England	4%	4%
Middle Atlantic	11%	12%
East N. Central	18%	19%
West N. Central	6%	9%
South Atlantic	36%	28%
East S. Central	3%	4%
West S. Central	7%	7%
Mountain	5%	5%
Pacific	10%	12%

FRINGE BENEFITS

ANALYSIS OF RETIREMENT BENEFITS BY ASSOCIATION SCOPE POSITION: ALL MANAGEMENT PERSONNEL

	Total No. of Assns.	% of Total Assns.	No. of National Assns.	% of National Assns.	No. of State/ Regional Assns.	% of State/ Regional Assns.	No. of Local Assns.	% of Local Assns.
Total Respondents	2,065	100%	846	100%	874	100%	345	100%
Types of Retirement Plans*								
One IRS Qualified Retirement Plan	987	48%	440	52%	415	48%	112	18%
More than One IRS Qualified Plan	60	6%	27	6%	30	7%	3	2%
Non-Qualified Deferred Compensation Plan(s)	220	11%	78	9%	105	12%	37	11%
Individual Retirement Acct. (IRA)	285	14%	94	11%	130	15%	61	18%
Tax Sheltered Annuity (TSA)	214	10%	125	15%	66	8%	23	7%
401 K	221	11%	110	13%	85	10%	26	8%
457	10	1%	5	1%	5	1%	0	0
Other	146	7%	54	6%	55	6%	27	8%
None (no plan)	360	17%	114	14%	164	18%	82	24%
Plan is:**								
Defined Benefit Plan	425	41%	211	48%	171	41%	43	33%
Defined Contribution Plan	365	37%	237	54%	245	59%	83	63%
Eligibility								
At age:								
21 and below	414	42%	200	45%	160	39%	54	41%
22-24	41	3%	12	3%	14	3%	5	4%
25	100	10%	44	10%	43	10%	13	10%
26-30	5	***	3	1%	1	***	1	1%
And/or after:								
1 year's employment	480	48%	211	48%	201	48%	68	52%
2 year's employment	15	4%	7	2%	16	4%	12	9%
3 or more year's employment	175	19%	72	18%	83	20%	20	15%
Vesting								
100% immediate	171	17%	71	22%	78	19%	22	17%
Graded 100% in:								
Less than 10 years	129	13%	151	14%	129	31%	49	37%
10 years	207	21%	90	21%	92	22%	25	19%
11-15 years	65	7%	35	8%	23	6%	7	6%
Cliff vesting: 100% after 10 yrs.	118	12%	47	11%	57	14%	14	11%
Other	28	3%	22	5%	6	1%	1	1%
Do not know	21	2%	11	3%	9	2%	1	1%

*Adds to more than 2,065 because of multiple plans.
**Percentages based on number of associations with retirement plans which provided information.
***Less than 1%.

FRINGE BENEFITS Continued

ANALYSIS OF RETIREMENT BENEFITS BY ASSOCIATION SCOPE
POSITION: ALL MANAGEMENT PERSONNEL

	Total No. of Assns.	% of Total Assns.	No. of National Assns.	% of National Assns.	No. of State/ Regional Assns.	% of State/ Regional Assns.	No. of Local Assns.	% of Local Assns.
Retirement age								
Normal retirement at:								
Under 62	33	3%	17	4%	13	3%	3	2%
62	23	2%	10	2%	9	2%	4	3%
65	746	76%	343	78%	313	75%	90	68%
Over 65	22	2%	10	2%	8	2%	4	3%
Other ages	2	*	0	0	2	1%	0	0
Early retirement at:								
Under 55	11	1%	8	2%	2	2%	1	1%
55	422	43%	174	40%	118	28%	30	23%
60	77	8%	48	11%	23	6%	6	5%
62	102	10%	38	9%	46	11%	18	14%
Other ages	20	2%	8	2%	11	3%	1	1%

*Less than 1%.

Senator PRYOR. A very fine statement, Mr. Robison. Thank you very much.

Mr. ROBISON. Thank you.

Senator PRYOR. I may have one question in a moment, but we are going to next hear from Mr. Leon Matthews, who is representing the United Way of Pulaski County, AR.

STATEMENT OF W. LEON MATTHEWS, PRESIDENT, UNITED WAY OF PULASKI COUNTY, LITTLE ROCK, AR

Mr. MATTHEWS. Thank you, Senator.

Other than the things that have been entered into the testimony, I would also like to indicate that I represent 417 United Ways in the Southeast. For the next 2 years I am sitting as the president of that part of the organization. So, in effect, we will be speaking not only for the United Way but for the United Ways in the South at the same time, Senator.

Senator PRYOR. Very good.

Mr. MATTHEWS. My experience with nonprofit organizations over most of my career of the last 30 years has given me an appreciation of the kinds of things we have to compete with in private sector companies in order to bring good people into our organizations. Because we are not able to compensate our employees the way some of the private sector can, we certainly found that the availability of flexible retirement plans is an important benefit the charitable organizations can offer to offset the higher salary levels in the private sector.

I want to congratulate you, Senator, on introducing this bill, S. 1426, and the subcommitee for holding these hearings.

We are supporting this legislation, specifically because of the provisions restoring some of the benefits of section 403(b), the tax-deferred annuity programs, and reputing the special restrictions for the top-heavy pension plans.

Many of the broader policy considerations underlying the United Way support of the proposed legislation will be addressed by Mr. Chris Semos in a few minutes, representing the Metropolitan Dallas United Way. I certainly support those statements that he will be outlining there.

S. 1426 contains provisions designed to ease the restrictions on section 403(b) programs imposed by the Tax Reform Act of 1986 and otherwise to make pension plans more attractive to small employers.

The proposed legislation seeks to cure the new constraints on section 403(b) programs in three respects, and this has been covered pretty well before:

By delaying the effective date of the new nondiscrimination rules applicable to the employer contributions to section 403(b) programs until 1990;

By modifying the reduced limit on volunteer contributions to section 403(b) programs, to allow for immediate indexing; and

By repealing the new withdrawal restrictions on such volunteer contributions.

With respect to the applicability of the nondiscrimination rules to employer contributions, part of the Tax Reform Act section 403(b) programs, unlike qualified pension plans, were not subject to any coverage or nondiscrimination rules. Even though many charitable organizations provide basic retirement coverage under section 403(b) with the employer contributions, and frequently mandatory employee matching, tax-exempt employer derive no tax subsidy from contributions to section 403(b) programs.

Thus, these nondiscrimination rules were not deemed necessary to prohibit employers from favoring highly-compensated employees. Application of the new nondiscrimination test developed in the Tax Reform Act to employer contributions will increase the operational complexity of administering the section 403(b) programs and will pose a new challenge to charitable organizations desirous of offering this benefit to their employees.

Therefore, a 1-year extension of the effective date of these new rules is a prudent way to ease the burden on affected organizations, and at the same time to allow them additional time to comply with the Tax Reform Act.

Mr. Heusi has already talked about indexing the limit on voluntary employee contributions. I think he said that very well, and it is indicated the same way in our testimony.

Another change that resulted from the Tax Reform Act was the imposition of withdrawal restrictions applicable to the TDA's, again, covered before. Before, and I guess in changing the rules in midstream, these amounts invested in TDA's are not subject to any withdrawal restrictions and, in effect, may create a burden. And I think the statement was made it may discourage employees from taking advantage of that program, except for separation of service or withdrawals on account of financial hardship.

Another aspect, I guess, of the Tax Reform Act that I was not aware of until earlier is that withdrawals on the financial hardship provision may only be made from elective deferrals but not the interest earned thereon. I think it would adversely affect employees

who contributed those TDA's with the expectation that they would have every reasonable access to those monies should the need arise.

Finally, the proposed legislation would repeal the special restrictions for qualified plans that are top heavy. Many local United Ways and other charitable organizations maintain qualified plans for their basic retirement program, as distinct from benefits that may also be provided pursuant to 403(b). Under the top-heavy rules, a plan is top heavy if 60 percent of the benefits are going to certain key employees—that is, corporate officers and owners. In our field we don't have corporate owners and officers, but it applies to executive directors, and so on.

So, if a plan is top heavy, the plan must adopt stricter vesting and funding standards, and distributions to key employees are restricted. I think the statements made by the other gentleman suffice in that area.

Senator PRYOR. Mr. Matthews, we appreciate your coming, and any part of that statement that you did not finish we are going to put in the record at the appropriate place.

Mr. Semos.

STATEMENT OF CHRIS V. SEMOS, COUNTY COMMISSIONER OF DALLAS COUNTY, TESTIFYING ON BEHALF OF UNITED WAY OF METROPOLITAN DALLAS, DALLAS, TX

Mr. SEMOS. Thank you, Mr. Chairman. I am Chris V. Semos, and I am presently serving my second term as a member of the Commissioners Court of Dallas County. Prior to that, I served for 16 years in the Texas House of Representatives, the last 8 years as chairman of the Business and Industry Committee.

I appear here today as a member of the board of directors for United Way of Metropolitan Dallas. Additionally, I am a member of the board of trustees and on the executive committee of United Way of Texas. I have worked with United Way for many years.

I would also like to add at this point that I, up until 3 years ago, was a small businessman all of my life in a family business, and through my involvement with United Way and other charitable educational and religious organizations, I have become familiar with the challenges facing these organizations as they attempt to compete with private sector companies for competent employees. Flexible retirement plans are important employee benefits that nonprofit organizations can offer their employees, and the availability of these plans should be encouraged.

United Way congratulates Senator Pryor for introducting this bill, and this subcommittee for holding these hearings on the Small Business Retirement and Benefit Extension Act of 1987. We are supporting this legislation specifically because of the provisions regarding Section 403(b), Tax Deferred Annuity Programs. These provisions apply both to the changes in the Tax Reform Act of 1986, with respect to employer contributions and to voluntary employee contributions.

You have my full statement, and so I will just summarize by saying United Way of Metropolitan Dallas supports three key provisions of the proposed bill:

First, delaying the effective date of the nondiscrimination rule applicable to Section 403(b), employer contributions;

Second, immediate indexing of the $9,500 cap on voluntary employee contributions; and

Third, repeal of the withdrawal restrictions.

These provisions will restore much of the flexibility of section 403(b), erased by the Tax Reform Act, and will benefit employees of charitable organizations such as United Way.

In conclusion, let me emphasize that United Way of Metropolitan Dallas supports the Small Business Retirement and Benefit Extension Act of 1987 in its entirety, and we hope that the views that I have expressed here on the provisions of that legislation affecting section 403(b) programs are helpful to this subcommittee.

I thank you very much, Mr. Chairman, for the privilege of allowing me to make this statement.

Senator PRYOR. Thank you very much, and thank you very much for coming.

[Mr. Semos' prepared statement follows:]

STATEMENT ON
THE SMALL BUSINESS RETIREMENT AND BENEFIT
EXTENSION ACT OF 1987, S. 1426

I am Chris V. Semos and I am presently serving my second term as a member of the Commissioners Court of Dallas County.

I appear here today as a member of the Board of Directors for United Way of Metropolitan Dallas. Additionally, I am a member of the Board of Trustees and on the Executive Committee of United Way of Texas. I have worked with United Way for approximately six years.

Through my involvement with United Way and other charitable, educational, and religious organizations, I have become familiar with the challenges facing these organizations as they attempt to compete with private sector companies for competent employees. Flexible retirement plans are an important employee benefit that non-profit organizations can offer their employees, and the availability of these plans should be encouraged.

United Way congratulates Senator Pryor for introducing this Bill and the Subcommittee for holding these hearings on the Small Business Retirement and Benefit Extension Act of 1987. We are supporting this legislation specifically because of the provisions regarding Section 403(b) tax-deferred annuity programs. These provisions apply both to changes in the Tax Reform Act of 1986 with respect to employer contributions and to voluntary employee contributions ("TDAs").

Many charitable organizations provide basic retirement coverage under Section 403(b) with employer contributions and, frequently, mandatory employee matching. In addition, TDAs represent the primary source of voluntary retirement savings for several million taxpayers employed by non-profit, tax-exempt charitable organizations, such as United Way and those organizations supported by United Way. Employees of these organizations generally participate in Section 403(b) programs on a voluntary, salary reduction basis. Tax-exempt employers do not share the usual private sector tax incentives nor often have the

resources to provide added encouragement to employee savings for retirement -- for example, through profit sharing or other employer matching arrangements. Accordingly, it is important that TDAs should be structured to encourage employees of charitable organizations to build adequate retirement income.

Moreover, because charitable organizations are not able to pay employees as well as their counterparts in the private business sector, the flexibility of TDAs must be maintained as an inducement to employment if charitable organizations are to be able to attract and retain competent employees.

The proposed legislation offered by Senator Pryor is designed to ameliorate the restrictions imposed on TDAs by the Tax Reform Act of 1986 in three key respects: (1) by delaying the effective date for the new nondiscrimination rules to be applied to employer contributions to Section 403(b) plans until 1990; (2) by modifying the reduced limit on voluntary contributions to TDAs to allow for indexing; and (3) by repealing the new withdrawal restrictions on such contributions. Enactment of this legislation will go a long way in ensuring that employees of charitable organizations have an ample opportunity to provide for their financial security in retirement.

With respect to the new nondiscrimination rules applicable to Section 403(b) plans, prior to the Tax Reform Act employer contributions under Section 403(b) were not subject to any nondiscrimination rules at all. Thus, the administrative calculations associated with application of these complex rules will pose a new challenge to tax-exempt organizations. Extension of the effective date for one year is a modest and reasonable way to ease the burden of applying these rules so that the affected organizations will have sufficient time to bring existing TDAs into compliance with the Tax Reform Act.

Additionally, indexing immediately the new reduced limit on voluntary contributions to TDAs -- rather than indexing it on a delayed basis as provided under the Tax Reform Act -- will ease

the impact of the Act on savings of those employees nearing retirement. As I stated previously, maximizing an employee's ability to participate in tax-favored retirement programs is a significant inducement for charitable organizations to attract and retain quality employees. Indexing the $9,500 contribution limit for TDAs will assist employees in saving for retirement, particularly as these employees approach retirement age.

Similarly, repealing the new withdrawal restrictions imposed by the Tax Reform Act will encourage employees to contribute to TDAs. Understandably, employees of charitable organizations may be reluctant to contribute sufficient sums to TDAs to provide adequate retirement income if access to those savings and the interest earned thereon is either restricted altogether or limited to but a few specified circumstances. As with the nondiscrimination rules, these withdrawal restrictions are new to TDAs and may well discourage voluntary retirement savings by those for whom the threshold decision to save is most difficult.

Finally, United Way supports the written testimony to be submitted by Mutual of America, an insurer of retirement plans of charitable human services organizations, including the United Way.

In conclusion, let me emphasize that United Way of Metropolitan Dallas supports the Small Business Retirement and Benefit Extension Act of 1987 in its entirety and we hope that the views that I have expressed here on the provisions of that legislation affecting Section 403(b) programs are helpful to this Subcommittee.

I thank you for this opportunity to present this statement. I will be happy to answer any questions that you may have regarding United Way of Metropolitan Dallas and our opinions on the proposals that I have discussed.

Senator PRYOR. If you don't mind, I may have a question for you and Mr. Matthews. You can decide which one would answer this—both, if necessary.

Have you calculated what the added administrative costs might be to your organization or to organizations such as yours because of the change in the nondiscrimination rules of the 1986 Act? Any calculation there of cost?

Mr. MATTHEWS. Senator, one of the statements that is in the record is that we support the statement that will be entered into this by Mutual of America, which is our company at the national level and serves most United Ways around the country.

I can tell you from personal experience on the new billings that we are just getting from them that the administrative cost has gone up. We are getting additional billings now on our TDA side on the investment portion that they use to make investments with.

I think the thing that concerns me most as I talk to agencies is that in fact of 44 agencies in our package, only 17 have retirement plans. And I think it is important, as we talk to them and give additional dollars to begin to add these things, that we can make it as simple as possible for them to incorporate these new plans in their package.

Senator PRYOR. A lot of people ask me—and I am going to ask Mr. Wilson this—why we should treat university professors and people who work in the nonprofit situations or associations, why we should treat them any differently than we treat those who are working out there in the private sector. How can I respond to my colleagues, Mr. Wilson, when they ask me that question?

Mr. WILSON. Well, equitable treatment is certainly in order, there is no question about that, Mr. Chairman. I guess I don't know what you are driving at with your question in terms of favoring college professors, which is essentially what I sense in your question.

Senator PRYOR. Well, more specifically, the nondiscrimination rules that you have spoken to, I think in your statement, the nondiscrimination rules, the implementation of those, or the changing of the effective date. And I am wondering how we can justify to our colleagues delaying that effective date.

Mr. WILSON. I am certainly not making that plea on the part of college and university professors. That would apply to all organizations, all activities that use the 403 instrument. The treatment there would apply to everyone who is favored by that kind of plan.

To go back to the previous panel and the question about why small businesses do not have as much in retirement plans as we see in higher education, I think it is because the retirement plans that have been used in higher education have been very simple. They have been easy to put in place, they have been easy to administer, and the nature of the enterprise has resulted in a situation where, as I indicated earlier, the vast majority have plans and there is no thought about taking those plans away.

What we are dealing with is a sea change now, as I indicated, that suggests that we have nondiscrimination rules to comply with. This is not going to be anything that is resisted by the campuses of the country or by the not-for-profit sector. It is simply a question of how do we comply with rules that we don't know about and rules

that are going to be a long time out in the future in front of us, as far as compliance is concerned.

I come from a university environment, and I certainly expect that word might get back there when I say that I am not making a case for college and university professors; it is for everyone who has been covered by 403(b) plans since their inception many years ago.

Senator PRYOR. We don't have anyone representing ministers here today, or do we? We heard an awful lot from ministers, one being my brother, who was a minister then in Galveston at the Presbyterian Church there, and he got very concerned about some of these plans.

Mr. Heusi, we sort of started meddling around with the catch-up rules, the catch-up provisions, in 1986 in the Tax Reform bill. Now, did we complicate the catch-up provisions? Or did we simplify them? You can be very frank, if you would like.

Mr. HEUSI. I think what you created was a monster.

Senator PRYOR. Now, how can we simplify that?

Mr. HEUSI. Well, I think the indexing of the $9,500 would probably give you and give those of us who are active, on one side or the other in this industry, a chance to at least get back and get in it.

What is unfortunate about the catch-up rules, or the lack thereof, is that you really need the capability toward the end of your career, if you have the wherewithal, to put that kind of money away.

Again, we go back to the cost. I don't think people seem to realize when they pass rules such as this that, if we don't get our people above the poverty line when they retire, somebody is going to end up on the Government's doorstep, because somebody is going to have to pay the price. And when you figure that the average cost of a pension is about $100,000 cash for a $10,000-a-year retirement income, which I might add is below the poverty line, you find yourself in a situation where you want to give as much flexibility and simplification to these rules as you can.

What has happened, if you go back, is—and I am going back probably 30 years now—we had a very simple formula to determine how much money you could put in, and there was no cap on it at all.

Then came ERISA, and we kept everything we had before and added three or four new layers of complexity. Some were just unbelievable. In fact, there is still, among the academics, great argument as to how to calculate some of those provisions.

Then came the next three acts, plus Tax Reform of 1986, and the net result is, we have taken something—and it is a wonder that the complexity hasn't broken the back of a very simple situation.

So, anything you can do—and I find myself most of the time when we are talking about bills in Washington going the other way; I am kind of pleased to come here and tell you I can support one.

So, I think what we really are after is the indexing of the $9,500. It is going to help considerably. But it is probably an area that ought to be revisited. I think your opening comment, when you introduced this bill, was that there were some changes made in haste

in Tax Reform of 1986 on the 403(b) side, and I think this goes a way to addressing that.

Senator PRYOR. I believe the statement has been made already this morning that we did that with probably less than one day of hearings. I think it was said "one day of hearing," but I think it was about a half-day of hearing that we had on any of this. I hated to see us wade off into it, but things were moving rather rapidly at that time, and it all became a part of what we were doing. Before you knew it, it was done. Now, I think we have got to look back and see what we can do to correct it.

Mr. HEUSI. I agree.

Senator PRYOR. Mr. Heusi, thank you.

Any further comments?

Mr. Semos.

Mr. SEMOS. Mr. Chairman, just one comment. You asked earlier about the difference between nonprofit groups and business organizations.

Senator PRYOR. Yes.

Mr. SEMOS. I would like to add that many nonprofit groups don't provide the encouragement to some employees saving for retirement. For example, through profit-sharing or other employer matching, these charitable organizations, and I might add small businesses of 25 and under, don't have that capability or the resources.

Senator PRYOR. A very good point.

Are there any further comments from our panelists this morning?

[No response.]

Senator PRYOR. Well, you brought a great deal of expertise and knowledge and information, and we are very appreciative. We thank all of you.

We will call our fourth panel now, our fourth and final, I might say.

I will return in 30 seconds.

[Whereupon, at 12:18 p.m., the hearing was recessed.]

AFTER RECESS

Senator PRYOR. After that brief departure, our fourth panel this morning will be Mary Nell Lehnhard, vice president of Blue Cross and Blue Shield Association; and Mr. Jacques Borel, founder and chief executive officer of Jacques Borel Enterprises.

We appreciate very much you coming. I believe you are accompanied by either counsel or friends.

STATEMENT OF DIANA C. JOST, EXECUTIVE DIRECTOR, PRIVATE MARKET PROGRAMS, BLUE CROSS AND BLUE SHIELD ASSOCIATION, WASHINGTON, DC, ACCOMPANIED BY ALAN RICHARDS, ESQUIRE, COUNSEL IN THE WASHINGTON OFFICE

Ms. JOST. Mr. Chairman, I am Diana Jost, not Mary Nell Lehnhard. Mary Nell Lehnhard has been taken ill and is unable to be with us today.

Senator PRYOR. Oh, I see.

Ms. JOST. I am accompanied by Alan Richards, who is a counsel in our Washington office.

Mr. Chairman, I regret to say I am not from Arkansas. [Laughter.]

I am here representing the 77 Blue Cross and Blue Shield plans across our Nation. They cover 77 million Americans, mostly through employment-based health insurance.

We appreciate this opportunity to comment on your bill. I will be brief; I understand you are under significant time restraints.

We will focus our testimony only on section 4(a), a provision to delay the effective date of the new nondiscrimination rules. We are specifically concerned with the health sections of that provision.

The rules are currently expected to go into effect for plan years beginning after December 31, 1987. S. 1426 would delay their effective date until December 31, 1990.

While the Blue Cross and Blue Shield Association does not disagree with the intent of the nondiscrimination legislation, we support the proposed delay in the effective date. Additional time is needed to review and revise the rules, to mitigate the discouraging effect they are likely to have on health benefit arrangements that allow employees to choose among several benefit options.

We believe that the rules will have a negative effect on current efforts to control health care costs. More specifically, the tests—or even the mere specter of having to apply the tests to multiple choice arrangements—could stifle the momentum of employers toward alternative ways of financing their employees' health care costs—HMO's, PPO's, and managed health care plans.

Employers introduce multiple choice plans for two reasons: to increase employee job satisfaction, and to control better the cost of health benefits. In our experience, employers do not design these plans with any intent to favor highly-compensated employees. In fact, Government policy has been to encourage multiple choice on the part of employees. The dual choice requirement under the Federal HMO Act is an example that comes immediately to mind.

We believe that the nondiscrimination rules will result in employers being concerned that their highly-compensated and nonhighly-compensated employees may distribute themselves—voluntarily—among the options in a way that causes one or more of the options or even the entire plan to fail. This concern, we believe, will drive employers toward offering only one benefit plan in order to assure compliance with the rules. This is the one absolute way that an employer can prevent the highly-compensated employees in a company from being eligible for or receiving more health benefits than the nonhighly-compensated employees.

While we are not able to offer suggestions to correct this problem, we would like to highlight our concern that the rules, as currently crafted, appear to be in conflict with other policies encouraged or mandated by Government. The goals of cost containment in the health care area and the issue of nondiscrimination in health care benefits are both important public policy priorities. Time is needed to modify the rules in order for both objectives to be met.

In closing, I would like to stress, once again, that the Blue Cross and Blue Shield Association does not disagree with the intent of

the nondiscrimination rules. However, we do not believe that the Congress intended the effect of these new rules to be the discouragement of development of cost-effective multiple choice options such as HMO's and PPO's. We strongly support the provision in S. 1426 that would delay the implementation of the effective date.

We are confident that these problems can be resolved and would like to express our willingness to work with you on improving these rules.

Thank you for allowing us to testify.

Senator PRYOR. Thank you very much for your testimony.

Now, you, please, pledge to help us now trying to uncomplicate some of this.

Ms. JOST. I am trying.

Senator PRYOR. In the organization you represent, you have vast resources. You may have more resources than this committee has. So, we are going to continue calling on you for your suggestions.

Ms. JOST. And we want to help you and intend to do so.

Thank you.

Senator PRYOR. Thank you very much.

[Ms. Jost's prepared statement follows:]

TESTIMONY

of the

BLUE CROSS AND BLUE SHIELD ASSOCIATION

by

DIANA C. JOST
EXECUTIVE DIRECTOR
PRIVATE MARKET PROGRAMS

Mr. Chairman, Members of the subcommittee, I am Diana Jost, Executive Director for Private Market Programs of the Blue Cross and Blue Shield Association. Our 77 member non-profit Plans provide health insurance protection to over 77 million Americans. The majority of this protection is in the form of employment-based group health benefits.

We appreciate this opportunity to comment on S. 1426, the Small Business Retirement and Benefit Extension Act. We will focus our testimony only on Section 4(a), a provision to delay the effective date of the new IRS Code Section 89 nondiscrimination rules as they affect employee health benefits. The rules are currently expected to go into effect for benefit plan years beginning after December 31, 1987. S. 1426 would delay their effective date until benefit plan years beginning after December 31, 1990.

While the Blue Cross and Blue Shield Association does not disagree with the intent of the original legislation we do support the proposed delay in the implementation date. Additional time is needed to review and revise the rules to mitigate the discouraging effect they are likely to have on health benefit arrangements that allow employees to choose among several benefit options.

BACKGROUND

Historically, the federal government has allowed employers a tax deduction for their contribution to employee health benefit plans and has allowed employees to exclude those employer-provided benefits from their taxable personal income. The purpose of this special tax treatment has been to promote widespread employment-based health insurance coverage of workers and their families.

The government has become concerned that highly compensated employees may have richer benefits than nonhighly compensated employees. More specifically, they are concerned that the government is inappropriately subsidizing the "excess benefit" because of current tax policy.

Thus, the nondiscrimination rules were enacted to assure that, unless a large percentage of a company's nonhighly compensated employees are receiving health benefits comparable to those received by the highly paid employees', the excess portion of the highly compensated employees' benefits will be included as part of their personal income and taxed accordingly.

We believe that the rules will have a negative effect on current efforts to control health care costs. More specifically, the tests -- or the mere specter of having to apply the tests to multiple choice arrangements -- could stifle the momentum of employers toward alternative ways of financing their employees' health care costs. Use of multiple choice arrangements under which health maintenance organizations (HMOs), preferred provider organizations (PPOs) and managed care plans are offered can provide coverage similar to more traditional benefit structures at lower cost to both employees and employers, or can provide more benefits to employees for the same cost.

In summary, we are concerned that the series of tests designed to carry out the intent of the provision is too complex and will be expensive for employers to perform. We believe that the deferred effective date will allow an opportunity to rework the rules to avoid these unintended effect on multiple choice plans.

MULTIPLE CHOICE HEALTH BENEFIT PLANS

Employers introduce multiple choice plans for two reasons: to increase employee job satisfaction and to control better the cost of health benefits. In our experience, employers do not design these plans with any intent to favor highly compensated over less highly compensated employees. In reality, government policy has been to encourage multiple choice on the part of employees. The dual choice requirement under the federal HMO Act is an example that comes immediately to mind.

We believe that the nondiscrimination rules will result in employers being concerned that their highly compensated and nonhighly compensated employees may distribute themselves -- voluntarily -- among the options in a way that causes one or more of the options or even the entire plan to fail. This concern, we believe, will also drive employers toward offering only one benefit plan in order to assure compliance with the rules. Again, that is the one absolute way that an employer can prevent the highly compensated employees in a company from being eligible for or receiving more health benefits than the nonhighly compensated employees.

We understand that under the new rules, if the values of every option in a multiple choice program are within 95 percent of every other option, they can all be combined and tested as though they were one plan. This aggregate testing would enable a multiple choice plan with nearly identical multiple options

to pass the tests, regardless of which options were selected by the employees. Making all the options nearly the same in value, however, would undercut the attractiveness of multiple choice to many employers and employees. This 95 percent value requirement, for example, might preclude an HMO option that has a 15 percent greater value in benefits, but is available at the same premium cost as other offerings, from being tested on a combined basis.

For employers with locations in several states the nondiscrimination rules will make establishing a multiple choice program virtually impossible unless each location can qualify under Section 89 for separate testing as a line of business or operating unit -- and many will be unable to qualify because their structure does not meet the criteria set out in the Tax Reform Act. Employers with numerous locations often are unable to offer all of their employees the same menu of health benefit options because all alternative benefit delivery systems may not be available at all locations. They may also find it impossible to implement multiple choice arrangements simultaneously at all locations, causing one or more options within those arrangements to fail the eligibility requirements.

FAMILY COVERAGE

The requirement to make all multiple choice options similar in value in order to test them as one plan will also adversely affect two-worker families. These employees do not necessarily want coverage equal to the richest benefit that either a highly compensated employee or a nonhighly compensated employee without a working spouse might select. Rather, they may want no health benefit at all, or perhaps a minimum package because their spouses have family coverage through another employer. Requiring those employees to choose only among health plan options that are very close in value to the highest option in the program would not promote a sound economic decision.

Another problem with family coverage not restricted to multiple choice plans is that many employers pay all of the premium for a single person but pay only part of the premium for family coverage provided their workers. Because family coverage must be tested separately under Section 89 and because in some small businesses the older, more highly compensated employees will tend to have family coverage while the younger employees will not -- because more of them are single -- family coverage will fail the benefits test or the alternative coverage test.

In these situations, some employers may react by ceasing to make a contribution to family coverage for both highly compensated and nonhighly compensated employees. If there is no employer contribution for family coverage there is no requirement that the family coverage be tested. In such cases employees would have family coverage only if they could afford to pay the entire premium themselves. This is not a desired outcome.

EXPERIMENTAL PRODUCTS

Prudent employers -- whether in a multiple choice situation or not -- often will want to experiment with a new benefit on a limited basis before making it generally available. There is no provision in Section 89 to accommodate limited benefit experiments or pilot projects which, without a special exception, may result in an employer violating the eligibility requirements.

CONCLUSION

During the time afforded by any delay in the effective date for the nondiscrimination rules, we would urge the Congress to explore ways to simplify Section 89 and assure that plans do

not fail merely because of the way employees voluntarily sort themselves out among multiple choice options.

While offering no specific suggestions for reform at the moment we would would like to highlight our concern that the rules as currently crafted result in conflict with other policies encouraged or mandated by government. Both the goals of cost containment in the health care area and the issue of nondiscrimination in health care benefits are both important public policy priorities. Time is needed to modify the rules in order for both objectives to be met.

In closing, I would like to stress, once again, that the Blue Cross and Blue Shield Association does not disagree with the intent of the legislation, that is, that health benefits plans, where offered to employees, should be made more uniformly available at comparable levels to all employees whether highly compensated or not. However, we do not believe the Congress intended the effect of these new rules to be the discouragement of development of cost-effective multiple choice options such as HMO's and PPO's. We strongly support the provision in S. 1426 that would delay the implementation of the effective date until benefit plan years beginning after December 31, 1990.

We are confident that these problems can be resolved and would like to express our willingness to work with you on improving these rules.

Thank you for allowing us to testify.

Senator PRYOR. Mr. Borel.

STATEMENT OF JACQUES BOREL, FOUNDER AND CHIEF EXECUTIVE OFFICER, JACQUES BOREL ENTERPRISES, INCORPORATED, NEW YORK, NY, ACCOMPANIED BY JACK MacDONALD, COUNSEL

Mr. BOREL. Mr. Chairman, my name is Jacques Borel. I am the founder and president of Jacques Borel Enterprises, Inc., a United States corporation headquartered in New York City. I am accompanied by my counsel Jack MacDonald, in case my knowledge of this country would not be good enough.

Senator PRYOR. Might I say that Mr. MacDonald and I go back a long time. We served together in the House of Representatives, and it is my pleasure and honor to have served with him some years ago.

Jack, we welcome you here.

Mr. MACDONALD. Thank you.

Senator PRYOR. Thank you.

Mr. BOREL. I am appearing before you today to describe my personal experience with the benefits of an employee meal system similar to that permitted by section 6 of S. 1426, your bill.

The United States law now effectively discriminates against small and medium-sized businesses in the availability of an important employee benefit, which is an employer-subsidized meal.

Present law permits an employer to subsidize a de minimis portion of meals furnished on a nondiscriminatory basis to all employees, provided that those meals are consumed on the business premises. Small and medium-sized employers who cannot provide on-premises eating facilities are effectively precluded from offering this benefit. The legislation which I am here to endorse would permit small and medium-sized employers to subsidize, in kind, a de minimis portion of an employee's meal consumed off the business premises at a nearby restaurant or shared cafeteria.

Since an off-premises employee meal allowance was enacted in Great Britain in 1948, legislation similar to that contained in S. 1426 has been adopted by nine Western European countries, in three Latin American countries, and in Hong Kong and Japan.

I became involved with the operation of an employee meal system in France in 1957, 30 years ago. I have since had personal experience administering these systems in Mexico, Hong Kong, Germany, Belgium, Italy, Spain, Portugal, and Brazil. In every country of which I am aware, enactment of this legislation has resulted in increased productivity, improved employee continuity and health, and increased revenues and employment in the food service industry for both restaurants and cafeterias.

The scarcity of skilled labor is a fact of the modern world, whether it is in New York City, in Mexico, in Tokyo, or in Moscow. Businesses in every major city in the world compete to hire, and most importantly to retain, quality personnel. In fact, for many small and medium-sized businesses, personnel costs are the single largest business expense. Furthermore, more than 60 percent of the United States workforce is now employed by businesses with fewer than 100 employees. The legislation which is before you today

would permit small and medium-sized employers to demonstrate their concern and gratitude to their employees in a tangible fashion through a de minimis meal subsidy, comparable to that traditionally offered by larger enterprises in a company cafeteria.

The experience of the United States' trading partners in Western Europe, Latin America, and Asia has demonstrated that this small benefit has a disproportionately favorable impact on employee productivity, loyalty, and job satisfaction, permitting small businesses to compete more fairly for this increasingly vital resource.

In businesses where an employee meal system is in place, statistics have shown that employees generally dine together at nearby restaurants or shared cafeterias, increasing their teamwork and morale.

Further, employees who dine under an employee meal plan generally consume a more nutritious meal in a shorter period of time than employees who rely on independent arrangements. These incidental effects are of incalculable value to businesses of any size, because they translate into increases in productivity and decreases in absenteeism and employee turnover.

I began my career in the food service industry as a small restauranteur in France. I experienced first-hand the difficulty of sustaining the operations of a small restaurant business through economic and social fluctuations. In the United States, for example, 75 percent of all restaurants fail in the first 5 years. In New York City, 12 percent of restaurants go bankrupt every year. This alarming statistic has devastating ramifications for the restaurant industry employees, which is the third largest employer in this country, who consist predominately of unskilled women, teenagers, and minorities. Job opportunities there are scarce.

Adoption of the employee meal system would create a new, and more importantly, stable source of business for small restaurants and cafeterias, enabling more of them to survive. My calculations show that, after 5 years when the system is fully in place, it will have generated approximately 35,000 new jobs in the United States of America.

Finally, because the revenue loss associated with exclusion of off-premises employee meal subsidies from the wage base, which is estimated by the Treasury at $92 million after 5 years, translates directly into increased sales and employment in the food service industry, the relatively nominal static revenue loss resulting from this legislation in other countries has been more than offset by the increased sales taxes and the income and employment taxes and profit taxes on restaurants. Using statistics from Western Europe, I have attempted to calculate these indirect revenue effects, and those calculations are contained in the appendix to my written testimony.

By the way, having helped in 11 countries already to implement this system, I would probably be one of the largest creator of taxes—creator of taxes—in the world.

Senator PRYOR. We need someone like you at this time, I could tell you, desperately, Mr. Borel. [Laughter.]

Mr. BOREL. This is why I chose to emigrate to this country 10 years ago.

Because I believe the employee meal system is good for business, good for jobs, good for employee health and safety, and therefore good for the United States of America, I strongly encourage you to report this legislation favorably, and I would be willing to answer any questions.

[Mr. Borel's prepared testimony follows:]

STATEMENT OF JACQUES BOREL
PRESIDENT, JACQUES BOREL ENTERPRISES, INC.
BEFORE THE
SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS
AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE
OF THE SENATE COMMITTEE ON FINANCE
OCTOBER 23, 1987

Mr. Chairman and members of the Subcommittee, my name is Jacques Borel and I am the founder and president of Jacques Borel Enterprises, Incorporated, a United States Corporation headquartered in New York City. I am appearing before you today to describe from my personal experience the benefits of an employee meal system similar to that permitted by Section 6 of S. 1426.

The United States tax law now effectively discriminates against small and medium sized businesses in the availability of an important employee benefit: an employer-subsidized meal. Present law permits an employer to subsidize a de minimis portion of meals furnished on a non-discriminatory basis to all employees, provided that those meals are consumed on the business premises. Small and medium sized employers who cannot provide on-premises eating facilities are effectively precluded from offering this benefit. The legislation which I am here to endorse would permit small and medium sized employers to subsidize in kind a de minimis portion of an employee's meal consumed off the business premises at a nearby restaurant or shared cafeteria.

Since an off-premises employee meal allowance was enacted in Great Britain in 1948, legislation similar to that contained in S. 1426 has been adopted in nine Western European countries, in three Latin American countries, and in Hong Kong and Japan. I became involved with the operation of an employee meal system in France in 1957. I have since had personal experience administering these systems in Mexico, Hong Kong, Germany, Belgium, Italy, Spain, Portugal and Brazil. In every country of which I am aware, enactment of this legislation has resulted in increased productivity, improved employee continuity and health, and

increased revenues and employment in the food service industry for both restaurants and cafeterias.

Businesses in every major city in the world compete to hire, and most importantly to retain, quality personnel. In fact, for many small and medium sized businesses, personnel costs are the single largest business expense. Further, more than 60 percent of the United States work force is now employed by businesses with fewer than 100 employees. The legislation which is before you today would permit small and medium sized employers to demonstrate their concern and gratitude to their employees in a tangible fashion through a de minimis meal subsidy, comparable to that traditionally offered by larger enterprises in a company cafeteria. The experience of the United States' trading partners in Western Europe, Latin America and Asia has demonstrated that this small benefit has a disproportionately favorable impact on employee productivity, loyalty and job satisfaction, permitting small businesses to compete more fairly for this increasingly vital resource.

In businesses where an employee meal system is in place, statistics have shown that employees generally dine together at nearby eating establishments or shared cafeterias, increasing their teamwork and morale. Further, employees who dine under an employee meal plan generally consume a more nutritious meal in a shorter period of time than employees who rely on independent arrangements. These incidental effects are of incalculable value to businesses of any size because they translate into increases in productivity and decreases in absenteeism, and employee turnover.

In addition, in all of the countries in which I have worked and with which I am familiar, I have found that the employee meal system is easy to institute and administer and does not result in tax cheating or counterfeiting, even where thousands of meals a day are involved. In fact, during the recent tragic earthquake which struck Mexico City, our employee meal system was utilized

by the Mexican government to distribute more than 5,000 meals daily over a three month period to persons who were made homeless by this disaster. The government chose this system in part because of its ease of adminstrability.

I began my career in the food service industry as a small restauranteur in France. I experienced first-hand the difficulty of sustaining the operations of a small restaurant business through economic and social fluctuations. In the United States, for example, approximately 75 percent of all restaurants fail during the first five years of operations, and in New York City, where my business is located, approximately 12 percent of all restaurants fail each year. This alarming statistic has devastating ramifications for the restaurant industry employees who consist predominantly of unskilled women, teenagers, and minorities for whom job opportunities are scarce and lost jobs are difficult, if not impossible, to replace. Adoption of the employee meal system would create a new, and more importantly stable, source of business for small restaurants and cafeterias enabling many more of them to survive. My calculations show that, after five years when the system is fully in place, it will have generated approximately 35,000 new jobs in the food service industry.

Finally, because the revenue loss associated with exclusion of off-premises employee meal subsidies from the wage base (estimated by the Treasury Department and the Joint Tax Committee to total $92 million cumulatively over a three year period) translates directly into increased sales and employment in the food service industry, the relatively nominal static revenue loss resulting from this legislation in other countries has been more than offset by the increased sales taxes and the income and employment taxes resulting from enhanced food service industry business and jobs. Using statistics from Western Europe, I have attempted to calculate these indirect revenue effects, and those calculations are contained in the appendix to my written testimony.

Because I believe that the employee meal system is good for business, good for jobs, good for employee health and safety, and, therefore, good for the United States of America, I strongly encourage you to report this legislation favorably. I would be pleased to answer any questions that you might have.

APPENDIX TO THE TESTIMONY OF JACQUES BOREL
PRESIDENT, JAQUES BOREL ENTERPRISES, INC.

S 1426 - Section 6

SUMMARY OF ECONOMIC EFFECTS

	1987	1992
Work Force	114,000,000 emp	125,000,000 emp
Employee Meals per day of the workforce	1,368,000 meals/day	1,500,000 meals/day
Average value of a meal	$3.36	$4.29 (5% inflation factor)
Number of meals per employee per year	230	230
Value of Meals per year (000)	$1,057,190,400	$1,480,050,000
Total new business produced in eating establishments, including cash payments		$1,154,439,000
Jobs created		24,826 40 hours/week 36,779 27 hours/week

The Following Analysis Is Computed As Of 1992 When It Is Assumed That The Employee Meal System Will Be Fully Implemented (5 years).

Estimated Static Federal Revenue Loss ($000)		$(92,600)
Income tax ($000)	$(54,268)	
Payroll tax($000)	$(38,332)	
Estimated Feedback Federal Revenue Gain ($000)		$161,734
Income Taxes paid by eating establishments ($000)	$57,722	
Income Taxes paid by new employees ($000)	$49,295	
Payroll Taxes ($000)	$54,717	
Total Estimated Federal Revenue Consequence		$ 69,134
Estimated State Tax Revenue Consequence ($000)		$157,372
Total Estimated Federal and State Revenue Consequence ($000)		$226,506

CONCLUSIONS

In terms of the average work week in the restaurant industry of 27 hours:

a) Discounting feedback revenue, the creation of one job will cost $(92,600,000)/36,779 = $2,517.

b) Counting feedback revenue at the federal level, the creation of one job will earn [$(92,600,000) + $161,734,000]/36,779 = $1,879.

c) Counting feedback revenue at the federal and state levels, the creation of one job will earn $226,506,000/36,779 = $6,158 per person employed per year.

ECONOMIC CONSIDERATIONS

In estimating tax revenue implications, a few assumptions have been made. In part these predictions are based on

European experiences, which, in view of the similarities of economies, can be considered as reasonable indications of the results that implementation of the employee meal system will have in the United States.

Since the employee meal system was started in Great Britain in 1948, legislation similar to that proposed has been adopted in nine Western European countries, three Latin American countries (Brazil, Mexico and Argentina), and two countries in the Asia-Pacific region (Hong Kong and Japan).

EMPLOYEE MEALS IN THE UNITED STATES

The principal assumptions are:

- 1.20 percent of the work force will participate in the employee meal system.
  (Source: this assumption was developed by the Treasury Department and the Joint Committee on Taxation for revenue estimation purposes.)

- 65 percent of the participants in the employee meal system will be new business for eating establishments as they were formerly brown bagging, skipping lunch or returning home. (In Paris, the estimate is 77 percent.)

- 20 percent is spent by the employee receiving the above meal coupon value. Because of the economic support given by the employer, the employee will tend to spend more.

  Estimates in Europe are that participants spend an additional 25% in Great Britain and between 25% and 70% in France above the value of the employee meal. As a conservative approach, 20% has been estimated in the assumptions for the United States.

- the average value of the employee meal is $3.36 (1987 value) and $4.29 (1992 value--the fifth year with a 5% inflation/year factor); one-third is paid by the employer and two-thirds by the employee (Source: Foodservice industry survey for the year ending August 1982)

- each employee will receive 230 employee meals per year (because of vacation, holidays, sick days, etc...).

U.S. Work Force (January 1992)	125,000,000 employees
Number of employee meals per day assuming system in full operation, (1.2 percent of the workforce)	1,500,000 meals/day
Total value of employee meals per year (1,500,000 meals/day x $4.29 x 230)	$1,480,050,000

FEDERAL REVENUE LOSS

In calculating this revenue estimate, two fundamental assumptions were made so as to correlate assumptions and methodology to that of the Treasury Department.

1. In estimating revenue loss, it is assumed that of the amount contributed by the employer (employer contributes one-third of which 50% is not taxable wage, i.e. one-sixth) the one half not deemed income to the employee is in the form of a non-taxable wage.

2. The average employee marginal Federal income tax rate (based on median income) is assumed to remain constant at 22% through 1992.

- Average marginal Federal income tax rate on wages	22%
- Value of employee meals per year ($000)	$1,480,050
- Share paid by employer: 1/3 of meal value	$ 493,350
- 50% of share paid by employer and not imputed income to employee ($000) in 1992 (50% of one-third equals one-sixth)	$ 246,675
- Total Federal Revenue Loss ($000) $246,675 x .22	$ 54,268

FICA is paid one-half (7.15%) by the employer and one-half (7.15%) by the employee. Unemployment tax has increased from 3.8% to 6.2% in 1987 and is entirely paid by the employer. However, the ceiling is very low, around an average of $9,000 per employee; in large cities where this system will apply, a small portion of employees, approximately 20%, make less than $9,000.

FICA plus unemployment taxes lost will then be:

FICA (14.3% of $246,675) ($000)	$ 35,274
Unemployment tax (6.2% of $246,675 x 20%)	$ 3,058
Total payroll taxes lost ($000)	$ 38,332

TOTAL ESTIMATED STATIC REVENUE LOSS

Federal revenue loss on income tax ($000)	$ 54,268
Federal revenue loss on payroll taxes ($000)	$ 38,332
Total income + payroll taxes lost ($000)	$ 92,600

EMPLOYMENT EFFECTS

The 1.2% of workforce participation in the employee meal system will result in a substantial increase of business and employment in eating establishments.

The 1982 estimated average hourly earnings for nonsupervisory restaurant employees is $4.08, or $5.21 in 1987 money. Assuming a 40 hour work week over an annual work year of 50 weeks, the average annual wage for 40 hour/week employees is $10,420. ($5.21 x 40 hours x 50 weeks = $10,420 (1987 money) or $13,299 in 1992 money assuming a 5% inflation factor annually.

The average payroll in a restaurant is 28.6% of gross sales. (Source: National Restaurant Association - Restaurant Industry Operations, Report 1982 prepared by Laventhol and Horwath.)

The jobs created in restaurants by the employee meal system can be estimated as follows:

$$\text{Jobs created} = \frac{\text{new business produced in restaurant x 28.6\%}}{\text{average salary of employees in restaurants}}$$

Value employee meals per year ($000)	$1,480,050
New business produced in eating establishments (65% new clients + 20% cash)	
(1,480,050 x 78%) ($000)	$1,154,439

Jobs created (40 hour/week equivalent)

($1,154,439,000 x 28.6%)/$13,299

24,826 employees

While it is estimated that 24,826 new 40 hour per week jobs will be created, it should be noted that since the average restaurant industry employee work week is 27 hours, the number of newly created jobs would rise to 36,779.

This estimate of 24,826 to 36,779 new jobs in the foodservice industry is particularly important since this industry is a principal source of employment for the structurally unemployed.

Foodservice industry employment today consists of 14% minority workers and 29.1% teenagers. With the current minority teenage unemployment rate at 19%, this new job market should help alleviate the severe structural unemployment problem in the United States.

FEDERAL REVENUE GAIN

Federal Income Taxes Paid by Eating Establishments

The additional business produced in eating establishments by the employee meal system will increase profits and create additional Federal income taxes paid by eating establishments.

Gross Profits on Incremental Sales (Source: National Restaurant Association - Table Service Operations, Report 77, prepared by Laventhol and Horwath.)	20.0%

Average Marginal Federal Income Taxes Paid (as percent of profit): 25.0%

Based on average taxable profit per restaurant of $65,729 in 1980 (Source: Restaurant Industry Operations - Report 81, prepared by Laventhol and Horwath) and present law corporate tax rates of 25% on taxable income between $50,000 and $75,000.

Additional Federal Income Taxes Paid by Eating Establishments

Value employee meals per year ($000)	$1,480,050
Total additional business produced in eating establishments (78%) ($000)	$1,154,439
Gross profit on incremental sales (20%) ($000)	$ 230,888
Federal income taxes gained (25%) ($000)	$ 57,722

Federal Income Taxes Paid by New Employees of Eating Establishments

Wages: average wages of restaurant employees are $10,420 in 1987 or $13,299 in 1992 (5th year of operation) assuming a 5% annual inflation factor.

Tips: estimated to occur on 23.4% of eating occasions with an average tip of 8.0% or 1.9% of new business.

Income of new employees represents:

Wages:	28.6% of new business produced
Tips:	1.9% of new business produced
TOTAL	30.5% of new business produced

Based on the 1981 Bureau of Labor Statistics median earning statistics for wage and salary workers of $15,900, adjusted for inflation to $21,308 in 1987 and $27,195 in 1992, and the rates of taxes payable by single taxpayers and married taxpayers effective July 1, 1983, assuming all take the standard deduction:

- Average restaurant employee wage $13,299 (1992 dollars)
- Median earnings for wage and salary workers $27,195
- Average tip of new restaurant employees

  (1.9% x $1,154.4 million)/24,826 employees = $ 883
- Average wage + average tip of new employees $14,182

Foodservice industry employment consists of 31.8% teenagers and 68.2% married men and women (BLS). It is assumed that teenagers have restaurant employment income as the only income source and all others have restaurant employment income as second income.

	Teenagers (31.8%)	Married Men and Women (68.2%)
ASSUME:	Standard deduction with one exemption	Standard deduction with two exemptions
Income	$14,182	$14,182 + $27,195 = $41,377
Income Tax	$ 1,602	$6,289
Effective Rate	11.3%	15.2%

Average Effective Rate - (31.8% x 11.3%) + (68.2% x 15.4%)
3.6% + 10.4%
= 14.0%

Income taxes paid by new employees of eating establishments:

- Value of employee meal per year ($000)	$1,480,050
- Total new business produced in eating establishments ($000) ($1,480,050 x 78%)	$1,154,439
- Additional income created ($000) ($1,154,439 x 30.5%)	$ 352,104
- Additional Federal Income Taxes paid by employees of eating establishments ($000) ($352,104 x 14.0%)	$ 49,295
- Additional FICA and Unemployment Taxes paid ($000) ($352,104 x 15.54%)	$ 54,717

TOTAL FEDERAL REVENUE GAIN ($000)

- Eating Establishments	$ 57,722	
- New Employees of Eating Establishments	$ 49,295	
- FICA and Unemployment Tax	$ 54,717	
TOTAL		$ 161,734

STATE REVENUE IMPLICATIONS

State tax authorities will realize significant gains in sales taxes and, additionally, savings in unemployment benefits otherwise paid.

STATE REVENUE LOSS

In calculating this revenue estimate, two fundamental assumptions were made so as to correlate assumptions and methodology to that of the Treasury Department and Joint Committee on Taxation.

1. In estimating revenue loss, it is assumed that of the one-third of the meal amount contributed by the employer, the 50% not deemed income to the employee is in the form of a non-taxable wage (one-third of 50% is one-sixth of the meal.)

2. The average employee marginal state income tax rate (based on median income) is assumed to remain constant at 3.5% through 1992.

   (This tax rate has been estimated from "Effective Rates of State Personal Income Taxes for Selected Adjusted Gross Income Levels, Married Couples with Two Dependents, 1980" Table 50, Advisory Commission on Intergovernmental Relations).

- Average Marginal State Income Tax Rate on Wages	3.5%
- Value employee meals per year ($000)	$1,480,050
- Share paid by employer and not imputed income to employee ($000) (1,480,050 x 1/3 x 50%)	$ 246,675
- Total State Revenue Loss ($000) ($246,675 x 3.5%)	$ (8,634)

STATE REVENUE GAIN

State Income Taxes Paid by Eating Establishments

The additional business produced in eating establishments by the employee meal will increase profits and create additional state income taxes paid by eating establishments. For purposes of these computations current average tax rates and industry percentages are assumed to remain constant through 1992.

Gross profit on incremental sales: (Source: National Restaurant Association - Table Service Operations, Report 77, prepared by Laventhol & Horwath).	20.0%
Average marginal state income taxes paid, assumed(as percent of profit):	5.4%

Based on the estimate that state corporate income taxes represent 18.1% of Federal

corporate income taxes (Source: Federal & local taxes as a percentage of GNP 1948-78 ACIR) and that the average Federal corporate taxes paid by eating establishments is 25.0% of profits.

Additional State Income Taxes Paid by Eating Establishments

Value employee meals per year ($000)	$1,480,050
Total additional business produced in eating establishments (78%) ($000)	$1,154,439
Gross profit on incremental sales (20%) ($000)	$ 230,888
State income taxes gained (54%) ($000)	$ 12,468

State Income Taxes Paid by New Employees of Eating Establishments

Wages: average wages of restaurant employees are $13,299 (1992 dollars)

Tips: estimated at 1.9% of new business

Income of new employees represents:

Salary:	28.6% of new business
Tips:	1.9% of new business
Total:	30.5% of new business

The effective state income tax rate paid by employees of eating establishments is estimated at 1.9%. (Source: "Effective rates of state personal income taxes for selected adjusted gross income levels, married with two dependents, 1977" ACIR - assuming total gross income of $21,400 for family).

Value employee meal per year ($000)	$1,480,050
Total new business produced in eating establishments ($000) ($1,480,050 x 78%)	$1,154,439
Additional income created ($000) ($1,154,439 x 30.5%)	$ 352,104
Additional state income taxes paid by employees of eating establishments ($000) ($352,104 x 1.9%)	$ 6,690

State Sales Tax

No sales tax is presently gained from employees who bring their lunches from home or who skip lunch.

However, consumption of an employee meal in a public eating establishment produces a sales tax. It is assumed that the average sales tax paid is 6.5%, since most of the in-kind meals will be created in large cities like New York, Chicago, Philadelphia, Washington, Los Angeles, San Francisco, Dallas and Houston where sales tax is higher than average.

In 1992, it is highly probably that average sales tax will be at least one percentage point higher, but this is not reflected in the computations.

Total value employee meals per year ($000)	$1,480,050
Additional business produced for eating establishments ($000) ($1,480,050 x 78%)	$1,154,439
State sales taxes gained ($000) ($1,154,439 x 6.5%)	$ 75,038

Unemployment Benefits Saved

Increased employment in eating establishments will result in savings in unemployment benefits. This is especially significant since eating establishments are major employers of structurally unemployed people--of total restaurant employment, 29.1% are teenagers and 14.0% are minorities.

Unemployment benefits are estimated at an average of 50% of salary earned before becoming unemployed.

It is assumed that only 43.5% of unemployed receive unemployment compensation. (Source: Joint Economic Committee-Economic Indicators January 1982--showing 6,047,000 unemployed with only 2,640,000 insured). The estimated savings do not include welfare payments that may be received by uninsured unemployed.

Unemployment Benefits Saved =
Jobs created x average salary x 50.0% x 43.5%

Jobs Created	24,826 (36,779 on the basis of 27 hours per week)	
Average salary of employee in eating establishments	$13,299	
Unemployment benefits saved ($000) (24,826 jobs x $13,299 x 50.0% x 43.5%)		$ 71,810

TOTAL STATE REVENUE IMPLICATIONS

State Revenue loss ($000)	$ (8,634)
State Revenue gain ($000)	$166,006

Eating establishments:	$12,468
New employees	6,690
State sales tax	75,038
Unemployment benefits saved:	$71,810

TOTAL STATE REVENUE GAIN ($000) $157,372

COST/BENEFIT ANALYSIS OF EMPLOYMENT EFFECTS

It is estimated that 24,826 new 40 hour per week jobs will be created in the foodservice industry by 1987. However, since the average work week in the industry is 27 hours, it is assumed that 36,779 people will be employed to fill those jobs. Based on the revenue estimates calculated above, the per person cost of creating these jobs is:

Static Federal revenue loss per person employed ($92,600,000/36,779) (computed on page 4) $ (2,517)

Net Federal revenue gain, i.e. static Federal loss plus Federal revenue gain, per person employed (computed on page 4)

[($92,600,000) + 161,734,000]/36,779 $ 1,879

Total Federal and state revenue gain, i.e. Static Federal loss plus Federal revenue gain and state revenue gain per person employed (computed on page 4).

[($92,600,000) + $161,734,000 + $157,372,000]/36,779 $ 6,158

Thus, using feedback revenue data, there is a savings of $6,158 per year for each job created in the foodservice industry by this legislation. However, even the static revenue cost of $2,517 per job created compares favorably with the $17,000 cost of each public works job estimated to result from the Highway Revenue Act of 1982 (P.L. 97-424), according to a fact sheet prepared by the Department of Transportation to accompany their original proposals ($5.5 billion revenue loss/320,000 new jobs created = ($17,188) per job).

Moreover, this DOT estimate includes both on and offsite jobs plus 150,000 "induced", service-related jobs (i.e. feedback type employment effects) without which the $17,000 per job revenue cost would almost double.

By comparison, the employee meal system is a highly cost-effective means of creating jobs in the foodservice industry while conferring benefits on employees of small businesses or branch offices equivalent to those now enjoyed by employees of larger enterprises.

Senator PRYOR. You have made a strong case and a strong statement. On behalf of this committee, I want to thank you.

Mr. MacDonald, do you desire to add in, to say anything?

Mr. MACDONALD. Well, I think we probably have here the world's leading expert in the food service business.

Senator PRYOR. I think we do.

Mr. MACDONALD. Mr. Borel has been in business in three continents, and started this food service business in Europe, in South America, and Asia, and I would certainly move to him for any further information that the committee may need.

Senator PRYOR. I have wondered about this section of the legislation, Mr. Borel. Are we opening up the possibility of abuse in the system? How do we prevent this in this legislation? How do we prevent abuse?

Mr. BOREL. Well, it is prevented several ways, which are very similar to the preventions taken by other legislation in other countries, which are, first that the bill true point is in kind—there is no transfer of money.

Senator PRYOR. There is no cash that is transferred between the employee and the restaurant, is that correct?

Mr. BOREL. Yes. The employee will pay his bill, on the one hand, with that meal coupon or meal voucher, and anything he would have eaten additionally, to the value of his meal. Supposing he has eaten four and a half dollars worth with a coupon of $4. He would add up two quarters. The restaurant is prevented from giving change, and this is controlled very strictly.

In other countries, very often we did cancel our contracts with restauranteurs that would give change, because we have to protect the employer who subsidized the meal, and we have to protect the nation who gives the tax advantage.

Also, the employer is prohibited from using the coupon for cosmetics, for cigarettes, for anything which is not food or which is not soft drinks. Alcoholic beverages are strictly prohibited, and this is controlled very severely, because this is the base of us to be in business.

Senator PRYOR. Do you have figures or statistics in your statement—I think you alluded to some—about how many businesses have their own cafeterias that subsidize?

Mr. BOREL. Yes. In this country you have approximately 20 percent of all employees who are covered by a company cafeteria, and 11 to 12 percent every day will patronize those cafeterias.

Senator PRYOR. And they are getting an advantage over these other individuals who do not have a cafeteria?

Mr. BOREL. Absolutely, big business. You know, all businesses are equal, but some businesses are more equal than others, and especially the small ones. That is not just specific to here, you know, that is specific, unfortunately, to all countries of the world I know of. I know only 35.

To come back to your question of the abuse, there have been very detailed surveys made by Hacienda in Brazil and by the Minister of Finance in France of what were the abuses, because any human enterprise—you know, of course, that—because of your responsibility, some kind of people will try to beat the system. And so, these very extensive surveys were made of how much, what is the per-

centage of compliance? Surprisingly, the percentage was nearly the same between France and Brazil—97.1 percent and 97.3 percent—97.3 was France, 97.1 was Brazil.

When I met Jean Pierre Fourcade, Minister of Finance in France, with the service, he was astonished because the fraud on value-added tax in France was in the neighborhood of 12 to 13 percent, because of subterranean economies, you know? And he told me, should we have the same degree of compliance with value-added tax, the budget would be balanced.

Senator PRYOR. A splendid statement, and I appreciate very much you coming. I know all the members of this committee will.

Mr. Richards, you have not made a statement. Do you care to say anything?

Mr. RICHARDS. I have nothing to add, Senator.

Senator PRYOR. Well, I just want to thank our four panelists today and the groups that you represent. I want to thank all of the witnesses who have appeared before this committee this morning. I think this has been a very informative and educational hearing. We are going to leave the record open for a period of about 1 week, to allow members of the committee to submit any questions in writing to any of our ladies and gentlemen who have given testimony before the committee this morning.

We are very grateful for the preparation that you have expended, also, in preparing these statements, to build upon this record so that we can really begin now to face some of the challenges of trying to take some program to the Congress—if not this year, certainly next year—to address some of the problems that we foresee.

Once again, Congressman MacDonald, we thank you for accompanying Mr. Borel, and we thank you all for being here as our panelists.

The meeting is concluded. Thank you.

[Whereupon, at 12:37 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT

OF THE

AMERICAN COUNCIL OF LIFE INSURANCE

This statement is submitted on behalf of the 690 member companies comprising the American Council of Life Insurance. Together their assets represent approximately 94% of the assets of all United States life insurance companies and more than 97% of the insured pension business.

The ACLI is pleased to voice its support for the "Small Business Retirement and Extension Act" (S.1426). Much of the pension legislation of recent years has had a chilling impact on the desire and ability of small business firms to sponsor a pension plan. Convincing a small business owner to establish a pension plan is extremely difficult, and in many cases impossible, because of the expense and complexity involved.

S.1426 recognizes this situation and proposes to remedy some of the problems through a combination of a new tax credit for small pension plan sponsors, repeal of the burdensome top-heavy rules that primarily impact small plans, and by easing the reporting requirements for small business pension plan sponsors. S. 1426 also allows non-profit firms to establish salary reduction annuity programs, repeals the excise tax on excess plan distributions, and extends the effective date of the very complex nondiscrimination rules for welfare benefit plans.

PENSIONS AND SMALL BUSINESS

The post-WWII baby boom produced a demographic tidal wave that has already had an enormous impact on our society. So far, we have witnessed its impact on our schools, the job market, and housing. In two decades, the baby boomers will begin retiring and our nation's retirement system will be challenged. Current studies clearly show that those who retire with income assistance from Social Security alone face a bleak retirement while those with personal savings and a private pension to supplement Social Security can look forward to a decent level of retirement income.

These same studies also reveal that many baby boomers are not participants in a pension plan at their place of employment. Data prepared by the Employee Benefit Research Institute reveal that while 70% of full-time workers are now participating in a pension plan, that percentage varies considerably by size of business. In firms with over 1,000 employees, pension participation is nearly universal (98%). It remains significantly high for firms with more than 250 employees (80%). But among those employees without pension coverage, 82% work in firms with less than 500 employees and 68% in firms with less than 100 employees.

What accounts for this disparity? The evidence is primarily anecdotal but overwhelming in magnitude. Costs and complexity are the top pension hurdles for small businesses. Most small firms operate on very tight margins and do not have significant discretionary resources to contribute towards establishing and maintaining pension programs. These firms also do not have the in-house sophistication to understand the immensely complicated rules inherent in sponsoring a pension plan and must therefore depend on the services of outside

counsel and employee benefit experts. To the extent employers must use a significant amount of their limited resources for plan administration and compliance, there would not be enough available to make meaningful pension contributions.

Moreover, there is a perception among small business owners that the rules governing pension plans are stacked against them. ERISA, DEFRA, REA, SEPPA, and TEFRA may sound like a child's magical chant to all but pension and tax lawyers. To small business, these are not just acronyms for massive new pension laws, but barriers between them and a pension plan for their employees. S. 1426 can help these business owners overcome these unnecessary impediments to a secure retirement for their employees.

At this juncture, our statement comments on the specific components of S. 1426.

SPECIFIC COMMENTS

Repeal of the Top-Heavy Plan Rules

Section 2 of S. 1426 repeals the special rules for top-heavy pension plans (plans in which more than 60% of benefits go to key employees) for plan years beginning after December 31, 1987.

The "top-heavy" rules were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982. Although these rules were intended to ensure an equitable distribution of tax-favored retirement benefits, they have added significant complexity and cost to the administration of small plans. The initial determination of whether a plan is top-heavy and the calculation of benefits or contributions to be credited to the various classes of employees under top-heavy plans are very complicated procedures and have created a deterrent to the creation of new plans by small employers.

The Tax Reform Act of 1986 made significant changes in the law governing qualified retirement plans, generally extending and duplicating the application of a number of the top-heavy concepts to all plans. For example, there is considerable overlap between the definition of "highly compensated employees" for purposes of applying the new nondiscrimination rules under the Tax Reform Act of 1986 and the definition of "key employees" under the top-heavy rules. The Tax Reform Act of 1986 also narrowed the gap between the vesting schedules for top-heavy plans and all other plans. Thus, all non top-heavy plans will have to have either five-year "cliff" vesting or a seven-year graduated vesting schedule under the new Tax Reform Act rules. By contrast, a top-heavy plan must have three-year "cliff" vesting or a six-year graduated vesting schedule. Finally, the Tax Reform Act of 1986 creates new standards for plan "integration" providing a minimum benefit for all lower paid workers which is very similar to the minimum non-integrated benefits that must be paid to non-key employees under top-heavy plans. Although there remain minor differences between the two sets of rules, the ACLI believes that repeal of the top-heavy rules will not sacrifice current safeguards against unduly favoring key employees. It will, however, remove a barrier that has prevented small employers from establishing qualified pension plans for employees who do not currently have any pension.

Pension Plan Administrative Cost Credit

Section 3 of S. 1426 allows a tax credit to small employers maintaining a tax qualified pension plan, including a simplified

employee pension plan. The credit, which is phased out for businesses having between 50 and 100 employees, is equal to the smaller of 14% of the contributions attributable to non-highly compensated employees or $3000 in the case of a defined contribution plan ($4500 in the case of a defined benefit plan).

Tax incentives have historically played a prominent role in encouraging employers to establish and maintain private pension plans. We continue to believe the tax credit is important to stimulate the creation of more private sector plans, particularly by small businesses. Moreover, in order to be truly effective, a tax credit must be a part of an overall small business pension incentive program. In this regard, the proposed elimination of the top heavy plan rules and the proposed simplification of certain reporting requirements also contained in S. 1426, are important complementary provisions which will help to eliminate some of the burdens associated with the establishment or maintenance of qualified plans by small business.

Simplification of Reporting Requirements for Small Plans

Section 5 of S. 1426 eliminates the ERISA requirement of a summary annual report for plans with fewer than 100 participants and requires simplification of all other required forms for such plans. We strongly endorse each of these proposed changes.

Currently, ERISA requires a plan administrator to furnish to each participant and beneficiary receiving benefits under an employee benefit plan, a summary of the annual report required to be filed by the plan with the Department of Labor. This requirement is burdensome and costly while the financial information called for is of little interest to plan participants. The requirement in S. 1426 that participants be notified of the availability of the annual report and the opportunity to request a copy is clearly sufficient to protect the interests of plan participants and beneficiaries.

The requirement that reporting forms be designed so that a person with no expertise in the employee benefits arena could easily complete them will remove yet another impediment against the establishment of plans by small employers. Most small plan sponsors are not knowledgeable in the employee benefits plan area and do not have an in-house staff of employee benefit experts. Therefore, it is very desirable to keep plan administration as simple as possible in order to reduce the costs of maintaining such plans.

Modification of Certain Provisions of the Tax Reform Act of 1986

Section 4 of S. 1426 reverses and delays several decisions made as part of the Tax Reform Act of 1986. We support each of the proposed changes.

(1) Extension of Effective date for Nondiscrimination Rules for Employee Benefit Plans. Section 4(a) of S. 1426 would delay the effective date of the new IRC Section 89 welfare benefit plan nondiscrimination rules. Under Section 89's current effective date provisions, these rules are generally scheduled to take effect three months after final Section 89 regulations are issued, but no earlier than for plan years beginning after December 31, 1987 and, (even if final regulations are not issued) no later than for plan years beginning after December 31, 1988.

S. 1426 would delay this schedule by three years, thus applying the Section 89 requirements no earlier than for plan years beginning after December 31, 1990, and no later than for plan years beginning after December 31, 1991. The ACLI strongly

supports this provision, which is necessary in light of the enormous administrative demands that Section 89 will impose on employers.

The basic thrust of the Section 89 requirements is to ensure, through a series of eligibility and benefit tests, that employee benefits, such as health and life insurance, are equitably distributed across a given workforce to both high and lower paid workers. If a particular plan or plans fails to meet the Section 89 tests, highly compensated employees are taxed on those portions of their benefits that exceed the Section 89 testing limits.

In order to apply these tests, however, Section 89 will require employers to collect enormous amounts of data, organize that data according to new, untried definitional concepts, and analyze actual year by year benefit choices made by employees. These burdensome requirements will apply to all employers, large and small, including the overwhelming majority of employers who have developed their benefit programs in good faith with the goal of providing nondiscriminatory coverage for their workers.

At present, employers and plan sponsors have no guidance as to a number of key issues under Section 89. Perhaps most significant is the absence of the table (required, under the statute, to be promulgated in regulations) setting forth the relative values of various health coverages for purposes of applying the Section 89 tests. Absent this table, it is difficult for employers and plan sponsors to know with certainty whether or not their health programs would meet the applicable Section 89 standards. Another important issue that needs to be further clarified before employers can confidently test their plans is the question of what constitutes a "separate line of business" under new IRC Section 414(r). Also, rules are needed to establish the testing procedures and dates before the complicated data gathering process can be established.

Although regulatory projects to address these issues are underway at the Internal Revenue Service and Treasury Department, it is clear that, under even the most optimistic work schedule, employers will not have guidance sufficiently far in advance of the current law December 31, 1988 outside deadline for application of the Section 89 testing.

Ever in areas where the rules are more clear-cut, employers need more time to reorganize their existing data bases to meet the demands of the Section 89 tests. This will include applying new criteria for determining the high-paid employee group, gathering data on many part-time employees for whom data was not previously required, and reexamining the employer's entire benefit structure in light of Section 89's narrower definition of what constitutes a separate "plan." Moreover, due to the peculiarities of testing family health coverages under Section 89, many employers will need to collect data about family status that has heretofore not been of concern, and, in many cases, procedures will need to be put in place for obtaining sworn statements from employees as to their family status and the extent of their health coverage outside the employer's plan.

For some employers who are now attempting to absorb the impact of Section 89 on their benefit plans, the process could result in program restructuring, with the attendant need to explain changes to employees and, where indicated, provide them with the opportunity to reassess benefit choices in light of program changes.

In sum, it is clear that compliance with Section 89 will require significant work and, in some cases, adjustment to ongoing benefit programs. In light of this, and the absence of timely

regulatory guidance on a number of key Section 89 issues, it is very important and appropriate to extend the Section 89 effective date.

(2) Modification of Provisions Relating to Section 403(b) Annuity Contracts. Section 4(c) of S. 1426 proposes several modifications to the provisions relating to Section 403(b) annuities: (i) Section 403(b) annuities would be made available to all tax-exempt organizations other than state or local governments; (ii) the restrictions on distributions attributable to contributions made pursuant to a salary reduction agreement would be repealed; and (iii) the effective date of the application of the general nondiscrimination rules to Section 403(b) arrangements would be delayed.

(i) Expansion of Availability of Section 403(b) Annuities. By way of background, the 1986 Tax Reform Act prohibited tax-exempt organizations from establishing qualified cash or deferred arrangements (Section 401(k) plans). In our view, there is no justification for precluding the availability of 401(k) pension savings plans to employees of tax-exempt employers. These employees have the same retirement needs as those of employees of "for profit" firms. Like Section 401(k) plans, Section 403(b) annuity arrangements are also used to provide, through cash or deferred arrangements, either basic or supplemental retirement income to employees. Since all but Section 501(c)(3) non-profit organizations and public schools are currently precluded from establishing 403(b) plans, it is appropriate to remove this prohibition and allow employees of all tax-exempt organizations to establish such arrangements and be treated equally under the tax code. It is to be noted, however, that the House budget reconciliation bill has a provision which would allow tax-exempt organizations to establish 401(k) plans. If this provision is enacted into law, the provision in S. 1426 expanding the use of Section 403(b) plans would become unnecessary.

(ii) Restrictions on Distributions from 403(b) Annuities. The 1986 Tax Reform Act also imposes restrictions on an employee's ability to withdraw elective deferrals from Section 403(b) plans. This restriction will act as a powerful disincentive to participation by all but highly compensated employees. For many Section 403(b) plans, particularly where there is no employer match, the flexibility to withdraw contributions is needed to encourage participation by the lower paid. Employees at all income levels should be encouraged to save for retirement.

(iii) Application of General Nondiscrimination Rules to 403(b) Annuities. Finally, the Tax Reform Act of 1986 requires Section 403(b) plans to comply with the nondiscrimination requirements applicable generally to corporate qualified plans. Compliance by Section 403(b) plans with these rules will involve substantial administrative costs and complexity and unnecessarily disrupt longstanding retirement programs of colleges and universities and other charities. There should be a considerable lead time before these significant burdens are imposed on these organizations.

Repeal of Tax on Excess Distributions. As a result of tax reform, annual distributions from all qualified plans and IRAs in excess of the greater of $112,500 or the defined benefit plan dollar limit will be subject to an additional 15% penalty tax. All distributions made with respect to any individual during a year are aggregated regardless of the form of the distribution or the number of recipients. The penalty tax will be imposed on many individuals who are receiving benefits which, in all respects, have complied with the Section 415 contribution and benefit limits. This result is impossible to justify.

AMERICAN SOCIETY OF PENSION ACTUARIES

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WRITTEN STATEMENT OF AMERICAN SOCIETY OF PENSION ACTUARIES
IN CONNECTION WITH THE SMALL BUSINESS
RETIREMENT AND BENEFIT EXTENSION ACT

November 11, 1987

The American Society of Pension Actuaries is a national organization representing more than 2,500 actuaries and consultants who provide actuarial, administrative, technical, and consulting services for approximately 30% of the tax-qualified retirement plans in the country. ASPA is pleased to provide these comments with respect to the Small Business Retirement and Benefit Extension Act.

As a preface to our comments, we provide you with the following statements which appear in a report compiled by the Ways and Means Committee in connection with "Retirement Income for an Aging Population":

- The number of elderly persons will increase rapidly in the future, both in absolute number and as a proportion of the population.

- Anemic real wage growth during the 1970's and so far into the 1980's, years when many of the baby boom began their work careers will, if continued into the future, slow the growth of retirement income and make harder the task of providing their income in retirement.

- The elderly population will more than double in size between 1980 and 2020. Between 1980 and 2020, an estimated 4.9 Million very old persons will be added to the population, but between 2020 and 2060, as the baby boom becomes very old, 8.3 Million will be added.

- Sufficient saving and investing is needed to accommodate both the baby boom's retirement and the needs of future generations.

- The historical stability of the private saving rate suggests that policies to raise private saving are unlikely to have a significant effect.

The Company-sponsored plan leg of the famous three-legged stool is beginning to crumble. Most of the crumbling is with respect to employees of small firms. It has been shown that approximately 19% of workers in firms with under 25 employees work for employers who offer pension coverage. This compares with 86% in firms with over 500 workers. We know from experience that the most prevalent reasons for small employers avoiding pension plans include administrative complexity, compliance with ever-changing laws, redundant rules, and over abundant paperwork.

With respect to the specific issues addressed in the Small Business Retirement and Benefit Extension Act, we offer the following comments:

1. The need for top-heavy rules for small plans has been eliminated by TRA '86 by extending a number of the top-heavy concepts to all plans.

2. A small employer must compete for qualified employees and such competition includes employee benefits. The Act helps that small employer to be on an equal footing with the larger employer with respect to employee benefits.

3. All of the issues in the Act respond to the recommendation made by the White House Conference on Small Business - to promote the retirement security of our nation's employees, Congress must support and promote the continued viability of the private retirement system in the small business community.

4. The tax credits offered by the Act for sponsoring new plans should not be considered a negative with respect to revenue raising. We are told that approximately $.86 of every $1 contributed to the private pension system returns to be taxed; the system has matured, since outgo from private pension plans now exceeds new deposits by more than $30 Billion.

5. The new 15% excise tax on excess accumulations discourages successful investment of retirement plan assets. We should not penalize a business owner who makes a benevolent decision to install a tax qualified retirement program for him and his employees, and proceeds to manage the program prudently and responsibly. If the plan adopted complies with all contribution and/or benefit limitations, then back end compliance is uncalled for.

6. The Act provides us with a unique opportunity not only to conform the rules with respect to small and large plans as they relate to the top-heavy conditions, it also provides us with an opportunity to correct the differences that continue to exist between 401(k) plans and 403(b) plans. Both programs are salary reduction programs, one applicable to employees of the private sector and one applicable to employees of the tax-exempt organization sector. The multitude of conditions that must be satisfied in order to protect the tax favoritism offered by 401(k) plans and 403(b) plans should be the same.

7. All efforts to keep simple the reporting and disclosure requirements of tax-qualified plans, and all rulings and regulations attendant to the tax qualification of a retirement program, are vehemently applauded. Noteworthy examples of this are:

   a. The preparation and distribution of Summary Annual Reports to plan participants has a value which approaches zero.

   b. The 5500-EZ concept has finally arrived, but should apply to more small plans than one person plans.

c. Publication of a 100 page plus proposed regulation on minimum distributions has been disheartening to all who deal with retirement programs. Because of its complexities, and the liabilities associated with the 50% penalty tax on less than minimum distributions, many distributees will be left to their own resources to calculate the minimum distribution requirement. Please tell us where a 71 year old individual can turn if the sponsor of his retirement vehicle will not provide him with the calculation of the minimum distribution alternatives.

The Small Business Retirement and Benefit Extension Act is a welcome bright spot of pension legislation proposed. The private pension system needs resuscitation - ERISA and ERTA were welcomed as needed regulations; TEFRA, DEFRA and REA were accepted as needed modifications; the system is near asphyxiation from TRA '86 and other continuing pension reform proposals. We sincerely hope that the Act is the first of many legislative proposals that will bring the private pension system back to where it should be - not just for the baby boomers, but for all who will not be able to sustain home and family on Social Security and private wealth alone.

Sincerely,

Howard M. Phillips, M.S.P.A.
Chairman, Government Affairs Committee

HMP:akm

STATEMENT ON BEHALF OF THE
ASSOCIATION FOR ADVANCED LIFE UNDERWRITING
AND THE
NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

Before the
Subcommittee on Private Retirement Plans
and Oversight of the Internal Revenue Service
of the
Senate Committee on Finance

Hearing on the Small Business Retirement
and Benefit Extension Act
S. 1426

November 20, 1987

On behalf of the Association for Advanced Life Underwriting (AALU) and the National Association of Life Underwriters (NALU), the following comments are submitted regarding selected provisions of the Small Business Retirement and Benefit Extension Act (S. 1426) (the "Act") pursuant to hearings held on October 28, 1987.

AALU is a nationwide organization whose membership consists of more than 1,400 life insurance agents and others engaged primarily in various aspects of life insurance marketing. Much of the work performed by our members relates to small businesses and deals often with qualified retirement plans and other employee compensation techniques.

NALU, which has a membership of 1,022 state and local associations with combined individual membership of over 125,000 life insurance agents, general agents and managers, joins AALU in the submission of these comments.

INTRODUCTORY COMMENTS

AALU and NALU are extremely concerned about Congress' approach to pension reform and its impact on small employers. In recent years, Congress has demonstrated a desire and a willingness to repeatedly revise the laws applicable to retirement and welfare plans. The frequency of such legislative change has produced a continuing problem for employee benefit plans. Just since 1979 there have been eight major bills affecting those plans generally and numerous more in the five years before 1980. The legislation since 1979 includes the following:

1986

The Tax Reform Act of 1986

1984

The Retirement Equity Act
The Tax Reform Act of 1984/Deficit Reduction Act

1983

Social Security Amendments Act

1982

The Tax Equity and Fiscal Responsibility Act
The Subchapter S Revision Act

1981

The Economic Recovery Tax Act

1980

The Multiemployer Pension Plan Amendment Act

The frequency of these changes adversely affects the stability of the retirement plan community and may well have long-term adverse affects on the retirement security of employees. Small employers particularly may be reluctant to adopt or maintain retirement plans in view of the frequency of change. It is in the small plan community where increased employee coverage by qualified plans is most needed.

Small employers employ approximately 55 percent of the nation's work force. In fact, nearly 88 percent of the businesses in the United States employ fewer than 20 employees. However, while small businesses employ the majority of the American labor force, plan sponsorship remains low among small businesses.

Several reasons exist for this low incidence of plan sponsorship. First, many small employers feel that they cannot afford pension plans given the instability of their profit margins and the need for reinvestment of earnings in the business. Second, for small firms the costs of plan administration are disproportionately high. Frequent legislative changes funnel monies that could be used to provide benefits into plan administration. Not only do legal changes require costly plan amendments, they also significantly increase the complexity and cost of plan administration. Small employers when confronted by a changing statutory scheme often unaccompanied by any regulatory guidance increasingly are compelled to employ plan consultants to ensure the continued qualification of their plans.

Further, limitation on the amount of benefits that small business owners can obtain from plans reduces the likelihood of their implementing a pension plan.

Likewise, reducing the pensions of higher-paid employees, through the application of more stringent nondiscrimination rules and reduction in benefit limits, often has a trickle-down effect on lower-paid employees through cutbacks in pension programs and benefits generally. Even if the employer continues its plan, often it will either fail to increase benefits, due to lack of availability of those increases to the more highly-paid employees, or will actually reduce future benefits for all employees.

Given these overall concerns, AALU and NALU applaud the Subcommittee for taking a well-balanced and long-term look at the goals of Internal Revenue Code retirement provisions and their impact on small employers.

DETAILED COMMENTS

Following are more detailed comments on selected provisions of the Act.

1. Repeal of the Top-Heavy Plan Rules.

Under current law a plan is defined as top-heavy if more than sixty percent of the accrued benefits (or contributions) are provided to key employees. A "key employee" is defined as an officer (receiving more than a specified amount in compensation), a five percent owner, a one percent owner with compensation in excess of $150,000, or the employees owning the ten largest interests in the firm (receiving more than a specified dollar amount). If a plan is top-heavy it must provide for vesting in accordance with one of two alternative vesting schedules. Thus, the plan must provide for either 100 percent vesting after three years or six year graded vesting beginning with 20 percent vesting after two years. Top-heavy plans must also provide minimum benefits or contributions for non-key employees. For non-key employees in a defined benefit plan the minimum benefit is 2 percent of the employee's average annual compensation multiplied by the number of the employee's years of service, up to a maximum of 20 percent of average annual compensation. The minimum contribution for non-key employees in a defined contribution plan is 3 percent of compensation (lower if the percentage for key employees is less than 3 percent). In determining benefits or contributions only $200,000 of a participant's compensation can be taken into account under the plan. If the employer sponsors both a defined benefit and a defined contribution plan, then additional limits will apply to the amount of benefits and contributions available under the plan.

The Act repeals the top-heavy plan rules effective for plan years beginning after December 31, 1987 thereby subjecting all retirement plans to the same rules regarding nondiscrimination and benefits and contributions limits.

AALU and NALU support the repeal of the top-heavy plan provisions of the Internal Revenue Code. We believe that the enactment of the Tax Reform Act of 1986 (the "1986 Act") obviates the necessity of the top-heavy plan rules. Moreover, the repeal of these provisions simplifies and reduces the cost of the administration of pension plans, especially for small employers.

The 1986 Act extends a number of top-heavy plan concepts to all retirement plans. For example, retirement plans may not discriminate in favor of "highly-compensated employees." The definition of highly-compensated employee is akin to that of key employee for top-heavy plan purposes.

Moreover, retirement plans must now provide for 100 percent vesting after five years of service or seven year graded vesting. In addition, if a plan provides that an employee is not eligible to participate before completion of two years of service, the plan must provide 100 percent immediate vesting.

Further, integration with Social Security can no longer absorb the entire benefit of the participant. Thus, each plan must actually provide some benefit. Likewise, as in the case of the top-heavy provisions, in determining the limits and benefits available under a plan there is a $200,000 cap on compensation taken into account.

Thus, most differences between the rules for top-heavy and nontop-heavy plans have been eliminated with the enactment of the 1986 Act. Minor differences, however, in vesting and minimum benefit and integration requirements continue to exist. While the top-heavy vesting schedules and minimum benefits requirements can, in some top-heavy plans, improve benefits of non-key employees, these added benefits may not be so significant so as to justify maintenance of the entire top-heavy regulatory structure. A balance is necessary between the delivery of benefits to non-key employees and a simplification and reduction of the cost of providing such benefits. For the small business owner for whom top-heavy plan rules have proved to be complicated and costly to administer, the current balance may be against sponsoring any retirement plan. Repeal of the top-heavy rules is an important first step in the simplification and promotion of pension plans for small employers.

2. Repeal of the Excise Tax on Excess Distributions From Pension Plans.

For distributions made after December 31, 1986, the Code imposes a 15 percent excise tax on excess distributions from qualified retirement plans, tax shelter annuity programs, and individual retirement accounts. An excess distribution is defined as the aggregate amount of retirement distributions made with

respect to an individual during any calendar year, to the extent that amount exceeds an annual ceiling. The annual ceiling for a year is the greater of (1) $150,000 or (2) $112,500 (as adjusted for inflation). Special rules apply with respect to lump sum distributions. The excess distribution excise tax is reduced by the amount of the 10 percent tax on early withdrawals.

The Act, recognizing the disincentives to retirement savings created by the enactment of the excess distribution excise tax, repeals the new tax. AALU and NALU support the repeal of the excess distribution excise tax. The excess distribution excise tax penalizes highly-compensated employees who are participants in plans that have positive yields on investments and those individuals who are covered by employer plans and also have individual retirement accounts. Such a tax policy discourages the prudent and successful investment of pension assets.

The signal sent to small employers contemplating whether to establish a retirement plan is one that they are to be penalized, rather than rewarded, for responsible plan management. Small employers generally assume large personal financial risks to establish and operate their companies. If these employers make an additional commitment to insure the retirement income protection of their employees and fulfill that commitment through the making of a distribution, no possible rationale for taxing the owners and employees exists. The excise tax simply acts to discourage the formation of retirement plans by small employers.

3. Administrative Cost Tax Credit.

Since the enactment of ERISA, the rules governing qualified retirement plans have been amended and rendered substantially more complex. Due to numerous changes in the law, plan documents must be constantly amended and such amendments filed with the responsible agencies. Such increased costs come at the same time that annual plan qualification rules require even greater expenditures on analysis by pension consultants to determine continued plan qualification.

These increased costs have an even greater impact on the small employer for whom administrative costs represent a larger dollar amount of expenditures. If Congress is concerned about the expansion of voluntary pension coverage, some method of alleviating the undue burdens imposed upon small plans must be considered.

AALU and NALU support the Act's creation of a tax credit for small employers maintaining retirement plans. This credit offsets the disproportionate costs of administration for small plans. While AALU and NALU are concerned about the revenue loss implications of any tax credit, the modest level of the credit and its

phase-out feature will reduce its revenue impact. Moreover, to be eligible for the credit employers must accelerate vesting for employees, with gradual vesting over the first three years and complete vesting at end of the fourth year of service. The credit thus rewards those employers who maintain plans which will provide minimum vested benefits to employees at a more accelerated rate than that which would be applicable under the nontop-heavy plan rules.

4. Effective Dates.

The 1986 Act enacted a complex set of new nondiscrimination rules applicable to health and other welfare benefit plans. Currently, these rules will become effective for years beginning after the later of (1) December 31, 1987, or (2) the earlier of (a) the date which is three months after the date on which the Secretary of the Treasury issues regulations, or (b) December 31, 1988.

The Act, recognizing the complexity engendered by these rules, would delay the effective date of the nondiscrimination rules by three years.

AALU and NALU support the three year delay. Such a delay will benefit administrators of all plans and will especially benefit small employers in complying with the complex rules. For example, small businesses currently are struggling to understand and comply with the new continuation coverage requirements of the Consolidated Omnibus Budget Reconciliation Act ("COBRA"). In addition, many small firms are experiencing the added cost to health plans of specific state mandated health insurance benefits. A delayed effective date for the 1986 Act nondiscrimination rules would help to ensure more efficient and timely compliance with the laws.

CONCLUDING COMMENTS

AALU and NALU remain very concerned about frequent changes in pension law that adversely affect small employers. We, therefore, urge Congress to enact the Small Business Retirement and Benefit Extension Act. Passage of the Act would remove much needless complexity from the law while also reducing the administrative costs of small employers. Such action will encourage the formation of retirement plans by small employers, thereby, ensuring greater retirement income security for the American work force.

AN ANALYSIS OF PROPOSALS

relating to

TAX SHELTERED ANNUITY PLANS under Section 403(b)

submitted by

THE COPELAND COMPANIES

SMALL BUSINESS RETIREMENT
AND BENEFIT EXTENSION ACT

S. 1426, sponsored by Senator David Pryor (and its companion bill, H.R. 2793, sponsored by Representative Robert Matsui) is designed to revise certain provisions of the Internal Revenue Code relating to tax-qualified retirement and benefit plans with the aim of eliminating disincentives that may cause small businesses and tax-exempt organizations from establishing and maintaining these plans for the benefit of their employees.

Some of the revisions that would be provided by the bill relate to changes made by the Tax Reform Act of 1986 concerning the requirements for and tax treatment of tax sheltered annuity plans pursuant to Section 403(b) of the Code.

SCOPE OF THIS STATEMENT

While Copeland generally supports the bill's legislative purpose of providing incentives for small business to provide appropriate and adequate retirement plans for the benefit of their employees, our statement for this hearings record is limited to our area of expertise - Section 403(b) tax sheltered annuity plans maintained by public schools and charitable tax-exempt organizations.

WHO IS THE COPELAND COMPANIES?

The Copeland Companies, including H.C. Copeland and Associates, Inc., is a nationwide organization devoted solely to the specialized marketing and administration of Section 403(b) tax sheltered annuity plans and certain related deferred income plans for tax-exempt and public employers. Copeland administers these plans for over 3,000 employers and over 200,000 participants.

BACKGROUND

Section 403(b) of the Internal Revenue Code authorizes an exclusion from federal income taxation of certain amounts of an employee's compensation which are contributed by his/her employer for the purchase of an annuity contract or custodial account which is specially designed to provide for retirement savings.

Taxes on the amounts contributed are deferred until a distribution is actually received, normally upon retirement.

Distributions are fully taxable as ordinary income when actually received; 5-year averaging tax treatment is not available. For a distribution made before the participant reaches age 59 1/2, an additional 10 percent penalty tax normally applies.

A tax sheltered annuity ["TSA"] plan may be provided only by a public school or by a Section 501(c)(3) charitable organization.

RATIONALE FOR TSA

In legislating the special provision for TSA plans, Congress recognized that the circumstances and needs of employers in the non-profit sector are very different from the needs of employers in the for-profit sector.

In general, a non-profit employer often has less money to devote to a qualified pension plan or other retirement plan. This generally happens for one or more of the following reasons:

- the tax-exempt employer's contributions to a plan are not "subsidized" through a corporate tax deduction;
- the non-profit employer is usually smaller in size than its counterpart in a for-profit industry, and thereby cannot benefit from the economies of scale that large businesses may use in establishing pension plans;
- the non-profit employer's particular charitable mission often results in a very limited or no budget being available for contributions to a retirement plan;

In legislating the special provision for TSA plans, Congress recognized that for many non-profit organizations, a TSA plan may be the primary, and in some cases, the only means of providing for sufficient retirement savings.

Recognizing that many non-profit employers do not have the resources to establish and administer a qualified pension plan, Congress legislated the TSA plan as an alternate method of allowing employers to help employees provide for their retirement.

However, it must be pointed out that the TSA plan can serve this intended aim only if it continues to provide for uncomplicated, easy-to-administer requirements.

The Section 403(b) TSA plan has proven to be a simple, convenient, consumer-oriented and effective means of helping

employees of charitable non-profit organizations to provide for their retirement. However, some of the "uniform" changes made by the Tax Reform Act of 1986 unnecessarily interfere with this purpose. The proposals set forth by the *Small Business Retirement and Benefit Extension Act* would restore some appropriate and much-needed advantages of the TSA plan.

ANALYSIS OF PROPOSALS

THE $9,500 ELECTIVE DEFERRAL LIMIT SHOULD BE INDEXED INDEPENDENTLY OF THE GENERAL $7,000 LIMIT BECAUSE TAX-EXEMPT ORGANIZATIONS MAY BE UNABLE TO MAKE SUBSTANTIAL EMPLOYER CONTRIBUTIONS.

Current law

The Tax Reform Act of 1986 provides that elective deferrals under certain qualified plans, including Section 401(k) plans, are generally limited to $7,000. TSA plans under Section 403(b) have a separate elective deferral limit of $9,500. However, this limit is not "indexed" until the regular $7,000 limit surpasses $9,500, and then a single elective deferral limit will apply to TSA plans as well as Section 401(k) plans.

Proposal

The bill would provide that the TSA $9,500 elective deferral limit is indexed without waiting for the regular $7,000 limit to exceed $9,500.

Analysis

We believe that the somewhat higher limit provided for TSA plans reflects the tax-writing Committees' understanding that employees of tax-exempt organizations may need to make larger elective contributions toward their own retirement savings because their employers are less generous in making non-elective or matching contributions in their behalf.

In part, this is because tax-exempt organizations, unlike their counterparts in the for-profit business world, do not have the cost of any employer contributions to a retirement plan reduced by a corporate tax deduction.

Also, we believe that the tax-writing Committees have continued their recognition that Section 501(c)(3) organizations, because of the nature of their operations as determined according to their unique charitable purposes, are likely to have a far more limited budget for retirement contributions.

Thus, because the tax-exempt employer may not be in a position to provide for substantial (or any) retirement contributions, the

employee who seeks to adequately provide for a secure retirement must do so by making somewhat larger elective contributions.

We believe that the the difference between the $9,500 limit and the $7,000 limit strikes an appropriate balance reflecting the special circumstances of employees of tax-exempt organizations. We recommend that this balance be maintained through independent "indexing" of these limits.

THE EFFECTIVE DATE FOR NON-DISCRIMINATION REQUIREMENTS SHOULD BE DELAYED IN ORDER TO GIVE EMPLOYERS SUFFICIENT TIME TO COLLECT NECESSARY INFORMATION AND REDESIGN PLANS TO ACHIEVE COMPLIANCE.

Current law

The Tax Reform Act of 1986 provides that TSA plans, beginning with 1989, are subject to the same non-discrimination requirements that apply to qualified pension plans.

Proposal

The bill would delay the effective date of these non-discrimination requirements until 1990, or until two years after final regulations are issued.

Analysis

We believe that this delay is warranted by the nature of the radical change made by the Tax Reform Act of 1986.

Before 1986, tax-exempt employers had never considered the possibility that TSA plans might be subject to the kind of non-discrimination requirements that apply to qualified pension plans, and which now apply to TSA plans.

In justifying this delay, we believe that the Committee should consider the sheer volume of information and data that the employer must collect before it can begin to evaluate whether a plan is likely to satisfy the non-discrimination requirements.

The necessary information includes data concerning each employee's age, years of service (measured under the Department of Labor regulations rather than by the employer's methods), compensation, elective deferrals, matching contributions, and non-elective contributions.

Many non-profit organizations have not developed computer systems or other means of storing and retrieving this soon-to-be-needed information. This is especially true of smaller organizations of fewer than 500 employees.

Consistent with similar effective date provisions legislated by the Tax Reform Act of 1986, we believe that it is appropriate to delay the effect of the non-discrimination requirements until after the Treasury department has issued final regulations providing guidance to employers.

Our experience in counselling a broad range of tax-exempt employers suggests that, given the complexity of the many rules governing this non-discrimination concept, we believe that it will be difficult, if not impossible, for employers to redesign their plans so as to comply with the new requirements without the benefit of Internal Revenue Service guidance.

This need for IRS guidance may be especially important for tax-exempt organizations, and particularly smaller organizations, since many tax-exempt organizations, because of their limited budgets, cannot afford to retain expert tax counsel to provide advice on these matters.

WITHDRAWAL RESTRICTIONS ON TSA PLANS DISCOURAGE RETIREMENT SAVINGS BY EMPLOYEES, AND ARE NOT NEEDED BECAUSE THE PENALTY TAX IS A SUFFICIENT DETERRENT AGAINST UNNECESSARY WITHDRAWALS.

Current law

The Tax Reform Act of 1986 provides that, except for a hardship (to be determined by the employer), a TSA participant may not receive a distribution from his/her account until s/he separates from service (retires) or reaches age 59 1/2. Also, any withdrawal before age 59 1/2, with certain limited exceptions, is subject to an additional 10 percent penalty tax.

Proposal

The bill would repeal the withdrawal restrictions (while preserving the penalty tax), thereby permitting a TSA participant to receive a distribution from his/her account at any time, subject to ordinary income tax and the additional 10 percent penalty tax.

Analysis

It is our experience that participants generally do not abuse the privilege of being able to receive a pre-retirement distribution from the TSA plan. This is because participants are aware that

an early withdrawal destroys the special tax advantages that first motivated them to participate in a TSA plan - that is, that the income will be taxed at a lower tax rate after the individual retires, rather than at the high marginal tax rate that applies when the individual is working.

We also have observed that restrictions against early withdrawal are generally counterproductive by frustrating the desire of employees to save for their retirement.

Many employees will not elect to participate in a TSA plan if they know that they cannot have access to their funds until retirement. This is especially true for lower- and middle-income employees. Although these individuals do fully intend to save for retirement purposes, they need to be secure in the knowledge that their money is available to them.

If the TSA plan includes withdrawal restrictions, many employees will not make the threshhold decision to participate in the plan. However, these employees usually later find that they do not need this money and that they can comfortably continue to save for their retirement.

Thus, it would be very unfortunate if these employees declined to participate because of their fears, justified or not, concerning their lack of access to their money; they will have missed the opportunity to provide much-needed savings for their retirement. Understanding the bill's legislative purpose of providing for qualified retirement plans which continue to encourage retirement savings, we suggest that the Committee consider whether the restriction against pre-retirement distribution has the unintended effect of perversely discouraging retirement savings. Based on our experience in explaining the TSA plan to employees, we believe that the effect of withdrawal restrictions may be especially damaging because it most strongly discourages lower-income and younger employees who have relatively little discretionary income to devote to restricted long-term savings, but also have the greatest need to provide for their retirement.

It should be noted that the new 10 percent penalty tax that now applies to early distributions from TSA plans will be a sufficient deterrent to prevent employees from abusing the tax preference of the TSA plan by taking unnecessary withdrawals. Assuming current interest rates, it takes approximately 15 years for the advantage of tax-deferred accumulation of earnings to outstrip the effect of the 10 percent penalty tax.

Even without considering the effect of the penalty tax, employees will naturally avoid taking an unnecessary pre-retirement withdrawal, because they know that this reduces their retirement savings which they can never replace.

American employees have become responsible about the need to save for retirement. Employees will not withdraw their retirement savings unless there is no other resource to satisfy an important family financial need. Given these natural desires, unnecessary withdrawal restrictions are contrary to the spirit of asking people to be responsible and self-sufficient.

A TSA PLAN SHOULD BE AVAILABLE TO ALL TAX-EXEMPT ORGANIZATIONS.

Current law

A TSA plan pursuant to Section 403(b) is available only to employees of public schools and Section 501(c)(3) organizations. Other tax-exempt organizations cannot provide a TSA plan.

Proposal

The bill would provide that all tax-exempt organizations may provide a TSA plan.

Analysis

This provision would fill an unfortunate gap in the kinds of retirement savings plans available to these other tax-exempt organizations that are not Section 501(c)(3) organizations.

The Internal Revenue Code provides for many different kinds of tax-exempt organizations other than the highly specialized Section 501(c)(3) charity.

Under current law, a tax-exempt organization that is not a Section 501(c)(3) organization generally does not have available any tax-deferred retirement plan permitting elective deferrals.

The Tax Reform Act of 1986 clarified that a Section 401(k) plan may not be adopted by tax-exempt organizations.

A salary reduction Simplified Employee Pension [SAR-SEP] plan is available only if the organization has no more than 25 employees. Further, even if the tax-exempt organization has fewer than 25 employees, it is very unlikely that voluntary participation by employees would satisfy the special non-discrimination rules that apply to a SAR-SEP plan.

At the same time, these tax-exempt organizations typically do not provide basic pension plans. Therefore, without a salary reduction plan available to them, these employees have no qualified employer-sponsored means of providing for retirement savings.

To achieve basic parity in allowing employees to provide for retirement savings, it is appropriate to permit all tax-exempt organizations to sponsor a TSA plan.

November 20, 1987

The Honorable David Pryor
Chairman
Subcommittee on Private Retirement Plans
and Oversight of the Internal Revenue Service
Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Pryor:

The Committee of Annuity Insurers is pleased to have this opportunity to advise you of our strong support for the 403(b) tax-deferred annuity provisions contained in section 4(c) of S. 1426, the Small Business Retirement and Benefit Extension Act of 1987. The Committee of Annuity Insurers, a coalition of 25 of the leading annuity writers in the United States, was formed in 1981 for the purpose of monitoring legislative and regulatory issues affecting the annuity issuer and the annuity policyholder.

Section 4(c) will ease the administrative burdens imposed on section 403(b) annuity programs by the Tax Reform Act of 1986 and will greatly enhance the ability of educators and employees of nonprofit organizations to save for retirement. We particulary are pleased that the bill will address the special needs of these individuals by: (1) repealing the withdrawal restrictions on contributions to salary reduction agreements; (2) indexing immediately the annual limit on such contributions; (3) delaying the effective date for implementation of the nondiscrimination rules; and (4) permitting all employees of tax-exempt organizations to participate in 403(b) annuity programs. We wholeheartedly endorse each of these changes.

Section 403(b) tax-deferred annuities represent the primary source of voluntary retirement savings for several million taxpayers employed by educational and charitable institutions. Such institutions do not have the private sector tax incentives nor do they generally have the resources to provide for their employees' retirement savings. Accordingly, it is important that such employees have access to a retirement plan that is structured so as to encourage their voluntary participation. The Committee of Annuity Insurers believes that repealing the newly-enacted withdrawal restrictions on contributions under a salary reduction agreement will provide such encouragement.

We believe that the present-law 403(b) withdrawal restrictions greatly inhibit the voluntary retirement savings of the lower- and middle-income individuals who are employed by educational institutions and charitable organizations and who wish to save for retirement, but are uncertain whether they can afford to do so. Understandably, such employees are reluctant to set aside sufficient retirement funds if access to those funds is either restricted or limited to a few, specified circumstances. Even if such employees do not intend to make a withdrawal prior to retirement, the knowledge that their monies would be available, if needed, can be the key factor in their decision to participate in a plan in the first place. Moreover, in light of the newly-enacted 10 percent penalty tax on distributions prior to age 59-1/2, we believe that the withdrawal restrictions are unneeded. The penalty tax alone is of such a magnitude to sufficiently discourage premature withdrawals.

Similarly, immediately indexing the annual limit on contributions to 403(b) annuities to take into account cost-of-living increases will assist employees in saving for their retirement, particulary as these individuals approach retirement age. Although, the majority of 403(b)

participants contribute less than the present $9,500 limit during the early parts of their career, older participants may be in a position to make contributions at that level. If the $9,500 limit is not indexed, the ability of these employees to provide for adequate retirement income will be eroded by increases in the cost-of-living.

We support postponing the effective date for the application of the newly-enacted nondiscrimination rules to 403(b) annuities. Prior to the 1986 Tax Act, 403(b) plans were not subject to the qualified plan nondiscrimination rules. Such rules generally are complex and will pose a new challenge to educational institutions and tax-exempt organizations. Furthermore, regulations providing guidance in this area have yet to be adopted. Once these regulations are adopted, affected institutions and organizations will need time to evaluate their plans and implement any required changes. The minimal delay in the effective date as provided by S. 1426 seems a modest and reasonable way to ease the burden of applying these new rules.

In addition, we believe that section 403(b) tax-deferred annuity purchase programs can be a valuable tool to attract and keep talented employees within the nonprofit community. Therefore, we agree that the availability of such programs should be extended to all tax-exempt organizatons that wish to establish them, as proposed in S. 1426.

The Committee of Annuity Insurers is pleased to support the provisions of the Small Business Retirement and Benefit Act which modify some of the restrictions imposed on section 403(b) tax-deferred annuity purchase programs under the Tax Reform Act of 1986. Maximizing an employee's ability to participate in retirement programs is a significant enducement for educational insitutions and charitable organizations to attract and retain quality employees. We believe that S. 1426 provides the flexibility and simplicity needed to effectively serve the special needs of such employees while minimizing the administrative burdens of the institutions and organizations that employ them. Section 4(c) of the bill addresses the particular needs and savings patterns of section 403(b) participants, and we respectfully urge its adoption.

Sincerely,

THE COMMITTEE OF ANNUITY INSURERS

Aetna Life & Casualty Insurance Company
Allstate Life Insurance Company
American Express Company
American General Life Insurance Company
American International Group
Anchor National Life Insurance Company
Capital Holding Corporation
Church Life Insurance Corporation
CIGNA Insurance Corporation
Equitable Life Assurance Society of the United States
Family Life Insurance Company
Guardian Life Insurance Company of America
Hartford Life Insurance Company
IDS Life Insurance Company
Integrated Resources Life Companies
Kemper Life Insurance Companies
Life Insurance Company of the Southwest
Metropolitan Life Security Insurance Companies
Nationwide Life Insurance Companies
New England Mutual Life Insurance Company
New York Life Insurance Company
Reliance Life Companies
Sun Life of Canada
The Manufacturers Life Insurance Company
The Travelers Companies

TESTIMONY

OF

CHURCH ALLIANCE

ON

S. 1426

The Church Alliance is a coalition consisting of the chief executive officers of the pension boards of 28 historic, mainline church denominations. These pension boards are charged with the provision of retirement and welfare benefits to the ministers and lay workers of this country, numbering in the hundreds of thousands.

The Church Alliance applauds S. 1426, the Small Business Retirement and Benefit Extension Act, introduced by Senator Pryor on June 25, 1987. Senator Pryor's bill would do much to make the provision of retirement benefits attractive to small employers, such as those served by church pension boards.

S. 1426 would relieve small employers of some of the burden of providing retirement benefits. The intricacy, complexity, and expense of maintaining retirement plans has multiplied in the last decade. Such factors can intimidate small employers from establishing retirement plans for their employees. S. 1426 would reduce some of these intimidating factors and encourage the provision of retirement benefits by more small employers.

S. 1426 would extend the provision of section 403(b) annuities to certain tax-exempt organizations other than 501(c)(3) organizations and public schools. Section 403(b) annuities provide simple, portable retirement benefits and should be available generally to tax-exempt organizations.

One provision of S. 1426 would repeal the restrictions in section 403(b)(11) of the Code on distributions of an employee's contributions to a section 403(b) annuity under a salary reduction arrangement. We support this provision because it would encourage employee participation in church plans and other plans and simplify plan administration.

S. 1426 would also delay the effective date of the new nondiscrimination rules to be imposed on certain welfare benefit plans and section 403(b) annuities. The Church Alliance particularly commends this provision. It will be almost impossible for churches and church ministry organizations to understand and implement the nondiscrimination rules within the time prescribed by the Tax Reform Act of 1986. The proposed delay will give churches the time to assess the need for rules which address their unique missions and structures.

S. 1426 also attempts to relieve in the case of small employers the burdensome reporting requirements of ERISA. The Church Alliance is sensitive to the paperwork problems of small employers and feels that much could be done for them to ease this kind of burden of plan administration.

The Church Alliance urges that S. 1426 be enacted in the shortest time span possible.

CHURCH ALLIANCE

By Gary S. Nash
Gary S. Nash, Secretary

WRITTEN STATEMENT OF THE
INVESTMENT COMPANY INSTITUTE

The Investment Company Institute, the national association of the American mutual fund industry, welcomes the opportunity to comment on S. 1426, the Small Business Retirement and Benefit Extension Act.

The Institute's membership includes 2,348 open-end investment companies ("mutual funds"), their investment advisers, and principal underwriters. Its mutual fund members have assets of about $926 billion, accounting for approximately 90% of total industry assets, and have over 29 million shareholders.

Mutual funds have traditionally served as vehicles through which investors of modest means may channel their investment dollars into the nation's economy through a diversified, professionally managed pool of investments. Mutual funds are increasingly providing the investment media for retirement income programs, including both qualified defined contribution and defined benefit plans, IRAs and simplified employee pensions (SEPs). In addition, many mutual funds sponsor prototype retirement programs for employers seeking to adopt a qualified plan or a SEP.

The Small Business Retirement and Benefit Extension Act has as its goals and objectives to encourage pension coverage of small business employees, and to give small employers incentive to provide larger benefits to employees already covered by pension plans. The Institute endorses these objectives, and supports the legislation in all respects save one, which is discussed below.

Proposed Repeal of Code Section 403(b)(11)

Section 4(c)(2) of S. 1426 would repeal Code section 403(b)(11), which was added to the Code by the Tax Reform Act of 1986. This section provides as follows:

> (11) REQUIREMENT THAT DISTRIBUTIONS NOT BEGIN BEFORE AGE 59-1/2, SEPARATION FROM SERVICE, DEATH, OR DISABILITY. -- This subsection shall not apply to any annuity contract unless under such contract distributions attributable to contributions made pursuant to a salary reduction agreement (within the meaning of section 402(g)(3)(C)) may be paid only --
>
> (A) when the employee attains age 59-1/2, separates from service, dies, or becomes disabled (within the meaning of section 72(m)(7)), or
>
> (B) in the case of hardship.
>
> Such contract may not provide for the distribution of any income attributable to such contributions in the case of hardship.

The floor statement accompanying introduction of S. 1426 states that the provisions concerning section 403(b) arrangements generally are intended "to help facilitate pension coverage for the employes [sic] of nonprofit organizations." The Institute submits that the repeal of section 403(b)(11) would not further this goal, and would instead perpetuate the previously inconsistent treatment of different types of section 403(b) arrangements.

Until 1974, section 403(b) arrangements could be funded only through annuity contracts. The Employee Retirement Income Security Act of 1974 (ERISA) added to section 403(b) a new

paragraph (7), which permits funding of a section 403(b) arrangement through a custodial account the assets of which are invested exclusively in stock issued by one or more regulated investment companies (i.e., mutual funds). In 1978, restrictions were imposed upon the conditions under which distributions may be made from section 403(b)(7) custodial accounts. Under section 403(b)(7)(A)(ii), amounts contributed to such an account may not be "paid or made available to any distributee before the employee dies, attains age 59-1/2, separates from service, becomes disabled (within the meaning of section 72(m)(7)), or encounters financial hardship."

The provisions governing section 403(b) annuity contracts did not contain such restrictions on distributions, however, until the enactment of section 403(b)(11) of the Code, which applies to tax years beginning after 1988. The legislative history of this provision describes prior law as follows:

> Under present law, withdrawals under a tax-sheltered annuity program invested in a custodial account of a regulated investment company (i.e., a mutual fund) may not be made prior to the time the account owner attains age 59-1/2, dies, becomes disabled, separates from service, or encounters financial hardship. In contrast, amounts invested in tax-sheltered annuities are not subject to any withdrawal restrictions. H.R. Rep. 99-841, 99th Cong., 2d Sess. II-452 (1986).

The purpose of new section 403(b)(11) is to extend "the withdrawal restrictions with respect to amounts under a tax-sheltered annuity program invested in a custodial account ... to elective deferrals and earnings thereon under a tax-sheltered annuity." Id. at II-455. Thus, section 403(b)(11) would rectify the inconsistent treatment of section 403(b) annuity contracts and section 403(b)(7) custodial accounts.

The Institute strongly opposes the proposed repeal of 403(b)(11), which would effect a return to the prior inequitable treatment of different types of section 403(b) arrangements that Congress recognized and resolved in 1986. No other distinctions between section 403(b) annuity contracts and section 403(b)(7) custodial accounts justify such disparate treatment of the retirement funding vehicles available to employees of nonprofit organizations. We submit that the repeal of section 403(b)(11) would not further the objective of increasing pension coverage of nonprofit employees, and thus should be stricken from S. 1426.

* * *

We thank the Subcommittee for the opportunity to present these comments.

STATEMENT OF THE HONORABLE ED JENKINS
BEFORE THE
SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND
OVERSIGHT OF THE INTERNAL REVENUE SERVICE OF
THE SENATE COMMITTEE ON FINANCE
OCTOBER 23, 1987

Mr. Chairman and members of the Private Retirement Plans and Oversight of the Internal Revenue Service Subcommittee, I have sponsored employee meal legislation in the House of Representatives for over five years, which is similar to Section 6 of S. 1426 which is before you today. This legislation would correct a de facto inequity in the tax law which discriminates against small businesses and their employees.

Present income tax law permits only those employers which have the physical and financial resources to provide a cafeteria on the business premises to offer de minimis meal subsidies (up to approximately 1/3 of the value of an employee meal) to their employees without adverse tax consequences. Small businesses which do not have adequate resources to provide cafeteria facilities on the business premises cannot offer a comparable benefit to their employees by any other means.

Because I believe that employee productivity and loyalty is vitally important to small business, I have chosen to sponsor this initiative which would permit an employer to subsidize a de minimis portion of an employee meal consumed off the business premises at a nearby restaurant or shared cafeteria.

I feel strongly about this legislation because it is both a matter of fundamental equity to small business and also a means of providing an economic stimulus to the food service industry which traditionally experiences a very high failure rate and consequent employee turnover. In fact, approximately 75 percent of all restaurants fail during the first five years of operations. This volatility has devastating impact on the industry and its employees who are predominantly unskilled women, minorities, and teenagers. Thus, the jobs which are lost in this turnover are difficult, if not impossible, to replace and contribute to our most hardcore unemployment.

It is my sincere belief that enactment of this legislation would promote job security within the food service industry and fairness for small businesses and their employees. I strongly urge you to give it favorable consideration and to recommend its passage by the Senate Finance Committee.

LAW OFFICES OF
KEMP, SMITH, DUNCAN & HAMMOND
A PROFESSIONAL CORPORATION
P. O. DRAWER 2800
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ROBERT B. ZABOROSKI

(915) 533-4424
2000 MBANK PLAZA

November 5, 1987

Ms. Laura Wilcox
Hearing Administrator
U.S. Senate, Committee on Finance
Room SD-205
Dirksen Senate Office Building
Washington, D.C. 20510

Re: Small Business Retirement and Benefit Extension Act (S. 1426)

Dear Ms. Wilcox:

I want you to know that I support the above-referenced legislation. As an attorney specializing in employee benefits, I am disturbed to see many of my small business clients terminating their retirement plans. This year I have terminated more plans than I have terminated during the preceding five year period. If I can assure other clients that legislative relief is forthcoming, perhaps I can avoid other contemplated terminations.

Yours sincerely,

Robert B. Zaboroski

RBZ/jrc

cc: Senator David Pryor

STATEMENT ON THE
SMALL BUSINESS RETIREMENT AND BENEFIT
EXTENSION ACT OF 1987, S. 1426

SUBMITTED TO THE
SENATE SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND
OVERSIGHT OF THE INTERNAL REVENUE SERVICE

Submitted by:

Mutual of America Life Insurance
Company
666 Fifth Avenue
New York, New York 10103

I am Dwight K. Bartlett, III, President of Mutual of America Life Insurance Company. I am pleased to submit this statement in support of the Small Business Retirement and Benefit Extension Act of 1987. I will first describe Mutual of America and then discuss the specific provisions of the bill.

Mutual of America is a tax-exempt, non-profit corporation whose primary business is underwriting employee benefit plans for the non-profit community. Mutual of America, which was previously known as National Health and Welfare Retirement Association, was founded in January 1945. The organization's founding fathers, who were primarily voluntary and professional leaders of the predecessors to United Ways and the organizations that they supported, sought to assure employee benefit programs for the staff members of their agencies.

Today, Mutual of America, which became our organization's name in 1984, is licensed in the District of Columbia and 50 states, with its home office in New York City and field offices in key cities throughout the country. At the end of 1986, Mutual of America was underwriting employee benefit plans covering approximately 150,000 employees who work for approximately 8,000 non-profit organizations. Its policyholders include many of the nation's prominent publicly supported charitable organizations, such as the United Way of America, United Ways in numerous communities nationwide, Girl Scouts of America, Goodwill Industries, Council of Jewish Federations, American Cancer Society, Association of Junior Leagues, and other hospital, philanthropic and charitable organizations.

Pension plans funded by Mutual of America annuity contracts include both defined benefit and defined contribution plans. Typically, the pension plans of Mutual of America's policyholders are small -- having 20 or fewer participants. Thus, the policyholders of Mutual of America fall squarely within the class of employers that will benefit from the provisions of the proposed legislation.

Mutual of America congratulates Senator Pryor for introducing this Bill and the Subcommittee for holding hearings on the Small Business Retirement and Benefit Extension Act of 1987. We are supporting this legislation specifically because of the provisions restoring some of the benefits of Section 403(b) tax-deferred annuity programs and repealing the special restrictions for "top-heavy" pension plans.

SECTION 403(b) PROGRAMS

The proposed legislation is designed to ease the restrictions on Section 403(b) programs imposed by the Tax Reform Act of 1986 ("Tax Reform Act") in three significant respects: (1) by delaying the effective date for the new nondiscrimination rules applicable to employer contributions to Section 403(b) programs; 1/ (2) by modifying the reduced limit on elective deferrals to Section 403(b) programs ("TDAs") to allow for immediate indexing for inflation; and (3) by repealing the new withdrawal restrictions on such elective contributions. The impact of the changes brought about as a result of the Tax Reform Act -- and consequently the importance of the proposed legislation -- can best be understood through a comparison of the nature of Section 403(b) programs before and after passage of the Tax Reform Act last year.

1/ Under the proposed legislation, the new requirements would be delayed until the later of (1) December 31, 1989, or (2) two years after final regulations implementing the provisions of the Tax Reform Act are issued.

(1) Overview

Tax-deferred annuity plans under Section 403(b) were introduced initially because there can be no tax incentive for tax-exempt charitable employers to make contributions to retirement savings. Therefore, the incentive was provided to the employee to encourage savings for retirement. These plans have served well the needs of employees of charitable organizations over many years.

Charitable employees, such as those of Mutual of America's policyholders, tend to be less well paid than their counterparts in the business sector. For example, in 1982, employees of philanthropic organizations had an average income of $12,525, as compared to $16,797 for the civilian work force as a whole.

While the disparity may be lessening, albeit slowly, the effects of years of low compensation on planning for retirement continue to be felt by those employees who have worked for years in the charitable community and are likely to be felt for some time in the future. With few exceptions, Mutual of America's policyholders simply cannot afford to offer the high-paying positions in which deferred compensation plans can make up for earlier low retirement savings, and in no event do charitable employers have such alternatives as stock options to compensate senior employees. Accordingly, these are not the plans likely to be of a kind that give rise to perceptions of abuse.

Most of Mutual of America's policyholders maintain qualified pension plans for their employees. However, Section 403(b) tax deferred annuities are used by Mutual of America policyholders to offer important incentives to encourage qualified applicants to accept, and to enable employees to remain in, lower paying jobs in the health and welfare sector.

(2) Nondiscrimination Rules

Prior to the Tax Reform Act, Section 403(b) programs -- unlike qualified pension plans -- were not subject to any coverage or nondiscrimination rules at all. Even though many charitable organizations provide basic retirement coverage under Section 403(b) with employer contributions and, frequently,

mandatory employee matching, employers derive no tax subsidy from contributions to Section 403(b) programs; thus, these programs were seen as employee contribution programs not requiring the same limitations as qualified plans.

Application of the new nondiscrimination tests developed in the Tax Reform Act to employer contributions will increase the operational complexity of administering Section 403(b) programs and will pose a new challenge to charitable organizations that want to offer or maintain such programs for their employees. These tests will also increase costs of administration. Moreover, many plans may face the need for increased employer contributions or reduced plan benefits.

The additional administrative costs associated with the applicability of these new requirements are difficult to estimate. The costs will vary from employer to employer depending on the amount of data, now being gathered on each employee, that would be readily available for analysis. For example, if an employer has a plan that currently covers all employees, much of the necessary employee data may already be at hand and additional administration could be minimal. Conversely, if the appropriate data is not readily available on all employees, the employer may be required to hire additional employees to gather the data and to perform the necessary recordkeeping.

An extension of the effective date of the new rules is a reasonable procedure by which to ease the impact on affected organizations and, at the same time, to allow them additional time to become familiar with and comply with the technical requirements of the Tax Reform Act. It is particularly appropriate to delay the effective date until after final regulations are issued in order to spare charitable organizations the costs and burden of altering plans to meet differing compliance requirements.

(3) Contribution Limit on Elective Deferrals

Immediately indexing the limit on elective employee contributions to TDAs likewise will lessen, somewhat, the impact of the Tax Reform Act on retirement savings. That Act reduced the limit on elective contributions to TDAs from $30,000 (or 25 percent of compensation, if less) to $9,500. The $9,500 limit would apply until the cost-of-living adjustments raised the $7,000 limit on deferrals under qualified cash or deferred arrangements to $9,500, at which time the limit on elective contributions to TDAs would become similarly indexed. This severe reduction in elective contribution limits most directly affects employees approaching retirement age who already have started contributing greater amounts to their TDAs.

While special catch-up elections raise the limits in some circumstances for some employees, 2/ those elections do not supplant the need to raise the limit on retirement savings as inflation rises for the broad spectrum of employees of charitable organizations. The catch-up provisions relating to the limitations on elective deferrals are confined to a specified group of employees -- those who have completed 15 years of service with the same employer -- and total catch-up contributions are limited to $15,000. Thus, many employees are not eligible to take advantage of this special catch-up election.

The provisions of the proposed legislation immediately indexing the reduced contribution limit -- independent of the contribution limit for qualified plans -- would restore some of the flexibility of Section 403(b) plans by enabling employees of charitable organizations to maintain the value of maximum contributions to their TDAs in preparation for retirement.

2/ The Tax Reform Act made employees of health and welfare service agencies -- like those insured by Mutual of America -- eligible for the catch-up elections under Section 415.

(4) Withdrawal Restrictions

Prior to the Tax Reform Act, Section 403(b) plans were not subject to any withdrawal restrictions. The Tax Reform Act provides that elective deferrals and earnings thereon may not be withdrawn before age 59-1/2, death, disability, or separation from service. Withdrawals on account of financial hardship may be made only from elective deferrals but not the interest earned thereon.

The recent changes to the long-standing tax favored treatment of Section 403(b) plans enacted as part of the Tax Reform Act may well have a chilling effect on participation in such plans, particularly because withdrawal flexibility is a significant inducement for employees of charitable organizations to contribute to these plans, and expectations have been built up over a long period of time. Imposition of these withdrawal restrictions will adversely affect employees who contributed to their TDAs with the expectation that they would have reasonable access to those monies, should the need arise, and may well discourage employees from contributing adequate sums to their TDAs to provide for their retirement.

Moreover, elimination of the restrictions, i.e., return to pre-Tax Reform Act conditions, should not result in abuse of these tax-favored plans. Because the terms of Section 403(b) plans typically include penalties for early withdrawal, participants are unlikely to make withdrawals except in cases of serious financial need. A study conducted by Mutual of America of activity involving its Section 403(b) plans -- prior to enactment of the Tax Reform Act of 1986 -- indicates that 7,134 withdrawals were made by individuals before age 59-1/2 between November 1, 1985 and June 30, 1986. Compared to the total of approximately 100,000 Section 403(b) records, withdrawals during

this period are equivalent to a withdrawal rate of merely seven percent. 3/

The proposed legislation would remove the new withdrawal restrictions, although withdrawals would presumably be subject to a penalty tax, and restore much of the attractiveness and flexibility of TDAs eradicated by the Tax Reform Act, without raising a realistic concern for abuse.

TOP-HEAVY RULES

Finally, the proposed legislation would repeal the special restrictions for qualified plans that are "top-heavy." Many charitable organizations maintain qualified plans for their basic retirement program, as distinct from benefits that may also be provided pursuant to Section 403(b). Under the "top-heavy" rules, a plan is "top-heavy" if more than 60 percent of benefits are going to certain "key employees" (e.g., corporate officers and owners). If a plan is "top-heavy," the plan must adopt stricter vesting and funding standards, and distributions to key employees are restricted.

"Top-heavy" rules are administratively cumbersome and unduly complex. These rules were adopted in lieu of more direct measures across the board to make plans fairer and the payment of minimum benefits assured. They bear very heavily and inappropriately on relatively small not-for-profit charitable and welfare organizations, which constitute a substantial percentage of Mutual of America's policyholders. Moreover, they

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3/ With respect to the analysis of early withdrawals, the following assumptions were made:

(a) Participants who are enrolled in Section 403(b) plans, but who may not have made contributions, are included in the total record count.

(b) If a participant took a withdrawal between November 1, 1985 and June 30, 1986, and took a subsequent withdrawal after June 30, 1986, the pre June 30, 1986, withdrawal is not reflected. This is because only the date of the last withdrawal is reflected in Mutual of America's records.

discriminate unfairly by imposing special conditions on some plans and not on others, and often have the perverse effect of imposing administrative and other costs on small firms and organizations that can afford them the least. Thus, retention of the rules, together with the new nondiscrimination provisions, may well discourage the continuation of plans by small organizations.

In order to determine whether a plan is "top heavy" and therefore subject to the "top-heavy" rules, a sophisticated analysis of the organization, its employees and the benefits and contributions to the involved retirement plan must be performed. The exercise of initially determining whether a plan is "top-heavy" is, in and of itself, a costly undertaking. Further, if the plan is "top-heavy," compliance with the "top-heavy" rules adds an enormous cost to a small organization that desires to provide a pension plan for its employees. For this reason, compliance with the "top-heavy" rules not only increases the administrative burden of providing a pension plan, particularly for small organizations, but also increases pension costs, in most cases, without any measurable benefit for employees.

Whatever the original limited justification for these rules, they certainly have no basis in the post-Tax Reform Act era. Uniform nondiscrimination rules assure that all tax-favored plans provide broad nondiscrimination coverage and that plans do not discriminate in fact; accelerated vesting schedules approximate the vesting requirements of the "top-heavy" rules. Indeed, the majority of Mutual of America's small plans, i.e., those with fewer than 50 participants, provide for 100 percent vesting with no service requirement for participation in the plan.

For these reasons, the redundant "top-heavy" rules with their negative consequences should be removed.

In conclusion, let me emphasize that Mutual of America supports the Small Business Retirement and Benefit Extension Act of 1987 in its entirety and we hope that the views expressed in this statement on the provisions of that legislation affecting Section 403(b) programs and "top-heavy" plans are helpful to this Subcommittee.

STATEMENT

OF THE

NATIONAL FEDERATION OF PARALEGAL ASSOCIATIONS

Executive Summary

The National Federation of Paralegal Associations, representing over 11,000 paralegals nationwide, opposes the repeal of the top-heavy provisions of TEFRA.

- There are over 61,000 paralegals in the U.S. today with that number expected to increase to 125,000 by the year 2000
- Approximately 80 percent of the paralegal work force is employed by law firms
- Pension plans in law firms are generally top-heavy
- Paralegals are among the lower paid employees in law firms
- Law firms generally do not provide career opportunities for paralegals who are forced to change jobs every few years to advance their careers
- Paralegals directly benefit from TEFRA's top-heavy provisions that provide minimum benefits and accelerated vesting

Repeal of TEFRA's top-heavy provisions will reduce or eliminate the future pension benefits of these paralegals.

The National Federation of Paralegal Associations ("NFPA"), founded in 1974, is a non-profit, professional organization of state and local paralegal associations. NFPA currently has 42 member associations representing over 11,000 paralegals across the country. NFPA reflects the diversity of the paralegal profession today and offers a forum for paralegals practicing in all sectors, including private law firms, corporations, legal service

agencies, financial institutions, educational institutions, the courts, trade associations and federal, state and local governments. NFPA strives to present a unified, national voice for the paralegal profession while advancing, fostering, and promoting the paralegal concept. NFPA also monitors and participates in developments in the paralegal profession and maintains a nationwide communcations network among paralegal associations and other members of the legal community.

NFPA is grateful for this opportunity to furnish written testimony on S. 1426, the Small Business Retirement and Extension Act, as we are particularly concerned with the measures in this bill which would repeal "top-heavy" pension rules. Such action would have a detrimental effect on the future retirement benefits of large numbers of paralegals.

Over the past 20 years, the paralegal profession has evolved from clerical positions which were held primarily by women. Today the profession remains dominated by women with men comprising about twenty percent of the group. The job responsibilities, however, are no longer clerical. In part, NFPA defines a Paralegal/Legal Assistant as a person qualified through training, education or work experience, to perform substantive legal work that requires knowledge of legal concepts and is customarily, but not exclusively, performed by a lawyer.

One of the latest projections of the U.S. Bureau of Labor Statistics ranks the paralegal profession foremost among the rapidly growing professions in the period between 1984 and 1995. In 1986 there were 61,000 paralegals, a fifteen percent increase from only two years earlier. The Bureau's Office of Economic Growth and Employment Projections estimates there will be 125,000 paralegals employed in the United States by the year 2000.

Although paralegals are afforded varied employment opportunities, the majority (80 percent or more) are employed by

law firms. Traditionally, career opportunities in law firms have resided exclusively with attorneys. Paralegals, on the other hand, are forced to change jobs every few years in order to advance their careers.

Prior to the enactment of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), pension plans in law firms primarily benefited partners, and many of these plans were and are top-heavy. Because paralegals frequently have short job tenure and are among the lower paid employees of these firms, they have directly benefited from TEFRA's requirements that top-heavy pension plans provide minimum benefits and accelerated vesting.

In March of 1987, the Bureau of National Affairs listed the average beginning salary of a lawyer at $41,370. When the Bureau of Labor Statistics releases its new figures in the Spring of 1988, the average entry level salary for a paralegal is expected to fall in the $16,000 to $16,500 range.

The top-heavy provisions of TEFRA served to remedy the inequities in pension plans which received favorable tax treatment for providing substantial retirement benefits for highly paid employees, while providing minimal or no benefits for lower paid employees. TEFRA imposes rules which ensure that top-heavy pension plans provide lower paid, non-key employees a share of the tax subsidized pension fund by requiring, in part, 100 percent vesting after three years (or six year graded vesting) and either a minimum benefit or minimum contribution depending on the type of plan.

A recent salary survey conducted by the National Capital Area Paralegal Association, a 650 member NFPA affiliate, included a section on employee benefits. The largest percentage of paralegals in the law firm sector who were eligible for participation in a pension plan indicated that they vested in three

years. Extensive canvassing of these members supports our position that the three year vesting was a direct result of the top-heavy provisions in TEFRA.

Private pension coverage remains inadequate to meet the needs of the growing work force employed by small business. The goals of S. 1426, to increase pension coverage and increase benefits within the small business sector, are commendable. However, as presently contemplated, this legislation would eliminate retirement security for a large sector of the labor force which now receives benefits as a direct result of the TEFRA top-heavy provisions. Paralegals are deeply concerned, as members of this labor force, that repeal of the TEFRA top-heavy provisions will reduce or eliminate their future pension benefits.

The NFPA strongly opposes repeal of the top-heavy provisions of the Tax Equity and Fiscal Responsibility Act of 1982.

STATEMENT OF JOSEPH SHANNON

UNITED FEDERATION OF TEACHERS

AND

RETIREMENT BOARD MEMBER,

NEW YORK CITY TEACHERS'

RETIREMENT SYSTEM

I am Legislative Director of the United Federation of Teachers ("UFT"), a major local union of the American Federation of Teachers, AFL-CIO, and have also served for nearly 16 years on the Retirement Board of the New York City Teachers' Retirement System where three UFT members represent the interests of more than 75,000 teachers and other eligible participants.

The New York City Teachers' Retirement System maintains two major retirement plans -- a defined benefit plan, and a Code section 403(b) annuity program which we call the TDA Program. Our TDA Program is funded solely on a salary reduction basis; employees may voluntarily elect to reduce future income and have that money set aside for retirement. The TDA Program is a supplemental defined contribution plan; member contributions plus earnings are used primarily to supplement fixed pension benefits at retirement. Our program is one of the largest of its kind and has proven to be very popular with our members.

We are pleased that the "Small Business Retirement and Benefit Extension Act" addresses an important problem -- a problem that has been of major concern to us ever since major tax reform proposals were first offered nearly three years ago. We strongly support section 4(c)(2) of the bill, which would prevent the 1986 Tax Reform Act restric-

ions on in-service withdrawals of section 403(b) contributions from taking effect in 1989. We believe that the new in-service withdrawal restrictions are counterproductive to good retirement policy.

A very real practical problem faced by New York City school employees is the difficulty of affording contributions to the TDA Program to assist their own retirement. Public school salaries are modest in comparison to private sector compensation, and the cost of living in New York City is high. Nevertheless, support for the TDA Program is strong, and over 25,000 persons -- about one-third of those eligible -- currently make contributions. While the average contribution is relatively modest, this money represents important retirement savings for TDA Program participants.

We have been and remain concerned that the restriction on in-service withdrawals, which will take effect in 1989 unless Congress acts to repeal them, will severely weaken the TDA Program. Our Program already discourages such withdrawals by prohibiting further contributions for two years after a withdrawal is made. However, experience has shown that some ability to withdraw funds in special situations is a critical factor in encouraging participation. Simply put, without reasonable access to their funds, many middle-income persons will be afraid to sacrifice their current income for retirement purposes.

We think the prohibition on "non-hardship" distributions of post-1988 contributions is likely to dramatically reduce participation in the TDA Program. Although highly

compensated persons are likely to have other funds available to meet emergencies, the resources of our members -- generally public school teachers -- are quite limited. The prohibition on non-hardship withdrawals may have been intended to increase retirement savings, but we are convinced that it will have precisely the opposite effect, i.e., that there will be significant reductions in retirement savings by those persons who have the greatest need for these funds. We believe this will occur even though the overwhelming majority of our members use the TDA Program primarily for retirement purposes.

For these reasons, we have consistently argued that any restrictions on pre-retirement distributions should take the form of reasonable "penalty" taxes -- such as the additional 10% tax included in the 1986 Act -- instead of outright restrictions. Now that the 10% tax is in place, the argument for repeal of these restrictions is even more compelling.

Finally, we are concerned that the new restrictions will create substantial confusion for our members as well as increasing administrative costs. It is unclear how or when "hardship" will be defined by IRS. Our members, however, will want to -- and have the right to -- know the ground rules before they contribute. And, in a Program as large as ours, we are concerned that the administrative costs and burdens of operating any "hardship" procedure will be too great.

I believe it is clear that the only real solution to these problems is to repeal the restrictions as S. 1426

would do. That solution is in the interests of our members and is good retirement policy.

We also support a second change that the bill would make in the section 403(b) area. Immediate indexing of the $9,500 annual limit will be particularly helpful to those of our members who start contributing late in their careers. These members should not be penalized with a fixed contribution limit -- one that could substantially decline in real dollars -- in the event that our economy experiences severe inflation in the years ahead.

We appreciate this opportunity to present our views on this important legislation. Please contact me (212-598-9229), or our Washington counsel, Lou Mazawey, of Groom and Nordberg, Chartered (202-857-0620) if any additional information would be helpful.

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November 4, 1987

Ms. Laura Wilcox
Hearing Administrator
U.S. Senate
Committee on Finance
Room SD-205
Dirksen Senate Office Bldg.
Washington, D.C. 20510

Gentlemen:

The rules relating to Pension and Profit Sharing Plans for small business greatly need simplification. There complexity surpasses understanding. If the rules are not simplified, small businesses will continue to terminate those plans, and the burden on the public sector to provide benefits through social security and otherwise will increase.

I believe that simpler rules can be drawn to effect the goal of providing necessary protection for employees without imposing such a great administrative burden on employers.

I personally think that the Tax Reform Act acceleration of vesting requirements and in particular reducing cliff vesting from five years to ten years will impose an unwarranted burden. However, since this change is in the law, I urge you to repeal the top heavy plan requirements. The top heavy plan rules impose a four year cliff vesting rule. It is really a great deal of unnecessary complexity to add all of these top heavy plan requirements to achieve a one year acceleration in cliff vesting.

Very truly yours,

Fred M. Ringel

FMR:vlh

cc: Ms. Mary McCauliffe

UNITED RESOURCES

November 19, 1987

Senator David Pryor
264 Russell Senate Office Building
Washington, D.C. 20510

The Honorable David Pryor:

We are writing to inform you of our strong support for S. 1426, the Small Business Retirement and Benefit Extension Act of 1987. While we support all provisions of the bill that encourage retirement savings, we particularly are pleased that section 4(c) addresses the special needs of educators and employees of nonprofit organizations by modifying some of the restrictions imposed on section 403(b) tax-deferred annuity purchase programs under the Tax Reform Act of 1986.

Section 4(c) will greatly enhance the ability of lower and middle-income employees in the educational and charitable sectors to save for retirement. Specifically, the bill would: (1) delay the effective date for application of the new nondiscrimination rules until 1990; (2) index the annual limit on voluntary contributions; (3) repeal the new withdrawal restrictions on such contributions; and (4) permit all employees of tax-exempt organizations to participate in 403(b) annuity programs. We enthusiasticaly endorse each of these changes.

As you are well aware, tax-deferred 403(b) annuities represent the primary source of voluntary retirement savings for several million taxpayers employed by educational institutions and nonprofit organizations. These individuals generally do not have access to the retirement benefits available to corporate employees, and their overall compensation tends to be lower than their private sector counterparts. Thus, if we are to encourage retirement savings by this segment of the workforce, it is necessary that they be offered the opportunity to save for retirement on reasonable terms. S. 1426 offers such an opportunity, and we respectfully urge its adoption.

Sincerely,

Philip T. Mortimer
President

PTM/dr

STATEMENT OF THE HONORABLE GUY VANDER JAGT
BEFORE THE
SUBCOMMITTEE ON PRIVATE REITREMENT PLANS
AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE
OF THE SENATE COMMITTEE ON FINANCE
OCTOBER 23, 1987

Mr. Chairman and members of the Subcommittee, Section 6 of S. 1426 which you have before you for consideration today contains legislation which I have introduced and strongly supported in the House of Representatives for almost ten years. This legislation, which has a nominal revenue cost of $92 million over three years, would simultaneously correct a de facto discrimination against small business owners and employees, create revenues and jobs within the food service industry, and promote economic productivity, health and safety.

Section 132 of the Internal Revenue Code permits employers to subsidize a de minimis portion of meals furnished to their employees on a nondiscriminatory basis provided that those meals are consumed on the business premises. However, more than sixty percent of the United States work force now works for employers with fewer than 100 employees. These small and medium-size businesses generally do not have the space or the financial resources to operate a company cafeteria and could not generate the economies of scale to make it profitable. Accordingly, the majority of workers cannot enjoy an employee benefit which is available generally to the employees of larger enterprises: an employer subsidized meal.

S. 1426 would permit small and medium sized businesses to furnish similar de minimis meal subsidies on a nondiscriminatory basis to their employees utilizing nearby restaurants or shared cafeterias. Statistics indicate that providing such subsidies encourages employees to dine together, to consume healthier food, and to return to work in a shorter period of time. All of these factors contribute to increased productivity for the employer and increased employee loyalty and satisfaction.

Thus, whereas most small businesses would rate their employees as their most valuable resource, current law prevents them from communicating the tangible gratitude and concern which is easily expressed provided by a larger business through utilization of a company cafeteria. The legislation which is before you today would correct this inequity in a way which enhances overall economic productivity by providing a needed stimulus to the food service industry. This industry, which experiences failure rates as high as seventy-five percent during the first five years of operations, is a major employer of minorities, teenagers, and women who desperately need the scarce job opportunities provided by small restaurants and cafeterias.

I am delighted that you will have the opportunity to consider this legislation, and I urge you to report it favorably to the Senate Finance Committee.

STATEMENT

OF THE

WOMEN'S EQUITY ACTION LEAGUE

The Women's Equity Action League (WEAL) welcomes this opportunity to submit written testimony concerning "The Small Business Retirement and Benefit Extension Act," S. 1426. WEAL, a national, non-profit, membership organization specializing in women's economic issues, conducts research and education projects, supports litigation, and lobbies. WEAL has played an active role in achieving the pension reforms contained in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), the Retirement Equity Act of 1984 (REA), and the Tax Reform Act of 1986 (TRA), as well as reforms for former foreign service, military and civil service spouses.

Emerging as a major national crisis, inadequate pension income is a leading cause of women's reduced economic circumstances in their retirement years. Women constitute 71% of today's 3.5 million elderly poor.

In 1986, 13% of women age 65 and older collected private pensions or annuities (including income received as a surviving spouse), receiving an average annual income of $3,074. In contrast, 31% of their male counterparts collected private pensions, averaging $5,325 in annual income.

In light of these statistics and WEAL's long history of working toward pension equity for women, we oppose any attempt to overturn hard-won pension rights for low-income women. The provision of the Small Business Retirement and Benefit Extension Act, which repeals the "top-heavy" plan rules established in TEFRA, would short-circuit many women's pension gains.

TEFRA's top-heavy rules were enacted to correct pension inequities in businesses and professional corporations that

provide large pension benefits--60% or more of accrued benefits in a defined benefit plan, or 60% or more of account balances in defined contribution plans--to highly-paid "key" employees, while paying little or no benefits to lower-paid employees. Women and other low-income employees of these firms became eligible for pension benefits for the first time under TEFRA's top-heavy rules. If these rules are repealed, women who had no pensions before TEFRA will find themselves once again without pension benefits.

Thus, rather than expand pension coverage, as supporters of the Small Business Retirement and Benefit Extension Act contend, S. 1426 will actually **decrease** coverage and pension benefits of workers who benefited from TEFRA reforms. No evidence suggests that removal of top-heavy restrictions will inspire small businesses to introduce voluntarily pensions for lower-paid workers. **The only certain effect will be reduction of pensions for those who need the benefits most.**

Two government studies show that, despite vesting and integration reforms under the Tax Reform Act of 1986, top-heavy rules continue to provide additional pension protection to low-income workers, especially women.

A 1984 report by the Congressional Research Service (CRS) contrasted TEFRA's minimum benefit rule with provisions that resemble those passed under TRA. The integration formula employed by CRS analysts is now the maximum integration allowed under TRA. The report showed that all low-paid workers with job tenures between five and 10 years would receive greater benefits using the minimum benefit requirement of top-heavy rules. Lower-paid women with job tenures as long as 20 years would also continue to receive greater benefits under these rules than under pension formulas calculated using the TRA permissible integration rate. **In other words, women received a greater benefit from top-heavy rules than from TRA.**

At Congressman Charles B. Rangel's request, the General Accounting Office (GAO) is reviewing the effect of replacing top-heavy vesting rules with TRA's new vesting schedules. Preliminary results show that if reviewed pension plans had used TRA 5-year cliff vesting or 3- to 7-year graded vesting, the proportion of women and men with NO vested benefits would have increased. Once again, workers would be adversely affected by the replacement of top-heavy rules, in this case vesting provisions, with rules contained in TRA. By adopting the TRA vesting schedule S. 1426 would reduce, not expand, pension opportunities for workers.

Given women's work patterns, the results of these studies have alarming implications for their retirement years. Employed women are more likely to work for a small business, at a low salary, and for just a few years. Their work pattern makes them no less deserving of access to retirement benefits.

Companies employing fewer than 100 people, where almost half of all women work, are generating the majority of new jobs. These are also the companies least likely to offer pension plans to their workers.

Women who are employed full-time, year-round stay an average of 3.3 years at one job; men's job tenures average 5.1 years. Job tenures for small business employees are even less; one in four workers stays with a company for three years. Women's shorter job tenures simply mean that they will be unlikely earn the right to a vested pension.

Finally, salaries--upon which pensions are based--are still substantially lower for women than for men. On the average women earn 65 cents for every dollar earned by men. However, the income ratio for women employed by small businesses is even lower than for women working in larger companies. According to the CRS study, women in most small businesses earned 40% of the salary of

men employees. Women employed by small professional corporations averaged 15% of men's earnings.

Because of disparities in wages and job tenure, and the prevalence of women workers in small businesses, especially the professional corporations, women continue to need and deserve the added protection of the top-heavy rules. These reforms must be kept in place.

WEAL cannot accept the contention of small business lobbyists that top-heavy rules are burdensome and cause plan terminations. Indeed, a recent study by the National Federation of Independent Businesses (NFIB) fails to substantiate these arguments. Responses to the NFIB study, although not numerous enough to be statistically reliable, reveal the attitudes of small business owners--not their representatives--toward top-heavy rules:

39% of respondents to the NFIB study do not offer a pension plan because they cannot afford to do so. Nine percent of these respondents cited start-up costs and red tape as reasons for not providing pension benefits. The number citing administrative costs was less than .05%.

For the remaining 61% percent who offered pension plans, the survey included a maintenance question that asked specifically about only one statutory provision: top-heavy rules. Despite being singled out, these rules were not problematic for the overwhelming majority of responding small business owners; they were cited as a major problem by only seven percent of respondents with plans. Constant government changes caused problems for 37%, and were the most frequently cited problems. Administrative costs followed, cited by 15%.

The NFIB survey responses show that top-heavy rules have little or no effect on whether small businesses implement pension plans, and are not problematic to plan maintenance.

The NFIB survey also questioned owners about plan terminations. 42% of owners terminated plans due to changes in the labor force and market-related factors, such as lower sales or profitability. NFIB noted a group "of almost identical size," 43%, cited changing, complex regulation and increased administrative costs as reasons for termination.

39% of those who canceled or withdrew from a plan now provide a different plan. Although there is no discussion of plans substituted for terminated ones, there is a good possibility that these newer plans were also subject to the top-heavy provision. **The NFIB study does not support the spurious claim that top-heavy rules cause pension plan terminations.**

Top-heavy rules were enacted five years ago. All plans subject to their terms have already been amended to comply with the law. No further (or costly) plan amendments are necessary and there are no additional or burdensome reporting requirements contained in the top-heavy rules. In fact, most companies have few enough employees that they need file financial information with the government only once in three years. It is ironic that small business advocates support repeal of top-heavy rules when the repeal would change government regulation and result in plan amendments and additional administrative costs that they claim are so burdensome.

Finally, the small business community argues that it is singled out and unfairly burdened by top-heavy rules: Small businesses are much more likely to be top-heavy than larger companies. They are not subject to many other non-discrimination provisions, such as the Age Discrimination in Employment Act, yet they are not complaining about lack of "parity" in these situations. If Congress must apply the same pension requirements to small and large companies, WEAL would gladly support efforts to apply the top-heavy 3-year or 2- to 6-year graded vesting and minimum benefit provisions across the board.

This Subcommittee should recognize that the laudable goal of increasing pension coverage, especially for small business employees who are less likely to be covered, is not served by repealing top-heavy rules. No significant correlation has been identified between the top-heavy rules, as opposed to any other ERISA and Tax Codes requirement, and failure to institute or maintain a pension plan. On the other hand, studies do show that lower-paid women workers are better off under top-heavy rules than under TRA pension equity reforms.

WEAL asks this Subcommittee to remember that low-wage members of our society, for whom these protective rules were originally enacted, sorely need the monthly pension benefit afforded them by top-heavy rules, regardless of the size of their benefit.

WEAL therefore urges Senator Pryor and the Finance Subcommittee to eliminate the repeal of top-heavy plan rules from this important piece of legislation, and to pursue other avenues that will truly enable and encourage small business owners to provide pensions for themselves and their workers.

We look forward to working with Senator Pryor and the Senate Finance Committee on this endeavor.

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